CZAR RESOURCES LTD.

INTERIM REPORT TO SHAREHOLDERS

SIX MONTHS ENDED
APRIL 30, 1981

REPORT TO THE SHAREHOLDERS TO APRIL 30, 1981

in summary . . .

Results of Czar's activity for the six months ended April 30, 1981 are as follows:

- Gross revenue increased 110% over the same period in 1980 to $7,592,275 due to higher production from Austin Chalk wells in Texas and more Canadian wells being on production.
- Cash flow from operations decreased slightly to $1,971,306 or $.20 per share from $2,153,471 in 1980 due to higher interest expense and administrative costs.
- Net earnings were $261,355 or $.03 per share, down from $772,520 in 1980.
- The average number of shares outstanding during the period was 9,732,937.
- The working capital deficiency at April 30, 1981 was $209,388. The Company has converted its Canadian bank line to a long term facility and will convert its United States line to a similar facility within the next month. The Company is very pleased with the flexibility offered by the new banking arrangements. The Canadian bank line does not require principal repayment for two years.
- Net proceeds from the issue of 1,800,000 common shares and share purchase warrants was $21,512,250 which was used to reduce bank indebtedness.

We would like to take this opportunity to bring you up to date in more detail than usual with respect to the activities of Czar during the past six months, and outline the Company's plans during this time of energy uncertainty.

Highlights

- Czar drilled 84 wells during the first six months of fiscal 1981 with the following results:

	Oil	Gas	Completing	Suspended	Dry
Canada	9	41	-	2	14
United States	2	1	11	-	4

- Czar has opened an office in Tulsa, Oklahoma, bringing to three its United States exploration offices. Czar intends to continue to expand its United States operations to take advantage of the higher product prices there.
- Czar has $12 million available from European investors for United States exploration in 1981 - 1982. These funds and the $20 million from Czar's public limited partnership in the United States will be spent on exploration and development in Colorado, Wyoming, Texas, Louisiana, Oklahoma, Montana, New Mexico and Kansas.
- Czar and Aurora Energy Fund Ltd. have filed a preliminary prospectus for the issue of units in a new company, Aurora-Czar Energy Co. Ltd. This offering will allow a rollover of limited partnership units into shares and provide up to $20 million for exploration in Canada in 1981 - 1982.
- Czar will concentrate Canadian drilling activity in areas of southern and central Alberta to develop natural gas prospects. New gas reserves will be sold to Sherritt Gordon Mines Ltd. beginning in 1983, thus increasing cash flow.
- During the winter drilling season a large accumulation of natural gas was proved up in the Helmet-Petitot area of British Columbia which may come on stream after 1985. External evaluations credit Czar with 59 billion cubic feet of natural gas, after royalty, on 58,000 acres. Czar has additional acreage holdings of 173,000 gross acres in this area.
- If proposed federal legislation is enacted in its present form, Czar believes it may be entitled to up to $4 million in petroleum incentive grants. The Company will be monitoring developments in the legislation and will seek these grants as soon as they are available.
- Sales of natural gas to Pro-Gas from Czar's Medicine River wells which began in June 1981 are expected to add about $100,000 per month to the Company's cash flow.
- Production for the six months net to Czar was:

Canada	Oil	78,560	barrels
	Gas	2,306	million cubic feet
United States	Oil	112,050	barrels
	Gas	63	million cubic feet

- Due to the discoveries in the Helmet-Petitot area, and a change in pricing adopted by an independent engineering evaluation firm to conform more closely with the National Energy Program, the Company's Canadian reserves were reevaluated to March 31, 1981. Canadian reserves, on an undiscounted basis, have increased 52% from those reported at October 31, 1980.
- Because of the uncertainties in Canada caused by the National Energy Program, continuing high interest rates and to monitor the orderly expansion of our growth oriented company the management of Czar has established a more comprehensive budgeting system in order to reduce expenditures, concentrate on developing cash flow and earnings, and obtain continued funding from drilling partners.

in detail . . .

In the development of any company, there are several key elements that establish the foundations for growth. In energy related organizations, the primary building block is the accumulation of oil and gas reserves. Czar, since incorporation in 1974, has demonstrated to its shareholders and investors, an excellent record in its ability to recognize potentially productive geological situations and to capitalize on this expertise to steadily increase its asset base through drilling operations. However, in our industry today, being successful in the exploration phase is perhaps only half of the battle.

In Canada, the combination of low product prices, the introduction of the petroleum and gas revenue tax, the restriction on the tax treatment accorded Canadian exploration expense and the phasing out of the earned depletion allowance, all introduced as part of the Federal Government's National Energy Program (NEP), along with a difficult gas marketing situation and skyrocketing interest rates, have slowed if not halted the growth of many independent Canadian oil and gas companies. The net result is that the second part of the independent's growth equation, involving revenues and cash flows, has been made that much more difficult to achieve. It is the opinion of Czar management that Canadian independents in these troublesome times must prove to the investment community that the ability to find hydrocarbons is combined with a competent philosophy. In this environment, the immediate goals of our company must be to take advantage of the positive elements of the NEP (the incentive grants for Canadian companies) and to concentrate on projects that are related to early cash flow and consequently a further reduction of corporate debt. This can be accomplished through an increase in the sales of Canadian natural gas and the continuation and expansion of operations in the United States where world scale pricing and the availability of markets combine to provide extremely favorable economics.

exploration outline . . .

Canada

The industrial usage contract that Czar negotiated for the sale of Alberta gas is extremely important. Despite the reduction in pricing that was necessary to acquire this contract, the economics of an early cash flow as opposed to further potentially lengthy shut-in periods are favorable. In addition, the contract with Sherritt Gordon Mines Limited was negotiated to allow for further exploration. A portion of the total reserves necessary to service the 17 year contract have been allocated to future drilling activities. This allows the Company to be aggressive in selected areas of the province while at the same time providing an attractive vehicle for investments for our drilling fund partnerships as they are involved in potential early cash flow generating prospects. Therefore the major emphasis for the Company's immediate Canadian exploration activity will be concentrated in these gas dedication areas of southern and central Alberta. This would include additional development wells in the Parkland-Claresholm area southeast of Calgary, where the Company has substantial proven reserves, and in the central Alberta areas of Manito- Leahurst and Buffalo Lake where individual low risk multi-zone prospects will be drilled. Recent examples of Czar's activities within these areas of concentration include Czar et al Parkland 10-10-15-27- W4M and Czar et al Regnier 5-30-41-20- W4M. The Parkland well is a dual zone gas well with indicated recoverable reserves of 18 billion cubic feet credited to the 640 acre spacing unit. The Regnier well is currently on stream to Sherritt Gordon Mines Limited at three million cubic feet per

day. Czar has drilled approximately 40 wells in the central Alberta area over the last two years with an eighty percent success ratio, and the new prospects have been modeled after the existing discoveries.

In British Columbia, Czar has a reserve base of 220 billion cubic feet of natural gas as determined by an independent engineering evaluation dated March 31, 1981 and interests in 442,047 acres of land with many development opportunities. The Company's present policy is dictated first by the current difficult price and marketing situation in the province but tempered with the realization that natural gas is a valuable future commodity in both the domestic and export markets. Thus, Czar will operate in British Columbia with a maintenance program on the Company's acreage, drilling only those wells deemed necessary to keep the lands in good standing. This activity would be expanded to a controlled exploratory and detailed development well program should we perceive a change in the pricing and marketing structure.

Mr. R.H. McClelland, Minister of Energy, Mines and Petroleum Resources stated in a June 16, 1981 speech that higher producer prices for B.C. gas would be announced shortly. In addition he outlined that sponsors of large scale energy projects such as the four liquified natural gas export terminals and the four gas based petrochemical projects are going to have to make commitments to carry out more exploratory drilling in the province to replace the gas being sold. Czar will closely monitor these developments in planning its British Columbia activities.

It is significant to mention that the Company has developed within the Petitot area of northeastern British Columbia a regional accumulation of natural gas of substantial reserve proportions. Our drilling activities over the last three winters indicate a potentially continuous Jean Marie formation gas reservoir at a depth of about 4,000 feet which covers over 2,300 square miles. All wells drilled to date into the pool illustrate geological continuity but more significantly demonstrate pressure continuity and reservoir characteristics that are indicative of a single homogeneous accumulation. The recently completed 1980-81 winter drilling program supported this concept as 16 out of the 17 wells drilled discovered natural gas. In-house estimates indicate the potential for a Jean Marie field of three trillion cubic feet of recoverable gas within British Columbia. Although few recent wells have been drilled in the southern Northwest Territories, geological examination of approximately twenty old wells leads our exploration staff to believe that only about half of the total pool is located in British Columbia and ultimate recoverable reserves may be doubled.

Within the British Columbia portion of the accumulation, Czar has interests in 231,000 acres with a further 54,000 acres under option. The March 31, 1981 engineering evaluation indicates proven and probable net reserves to Czar of 59 billion cubic feet of gas for the 58,000 acres evaluated with 220 billion cubic feet of gross reserves. In-house regional reserve evaluations indicate this gross potential may ultimately be 680 billion cubic feet once all Czar acreage is evaluated. Management advises that such an evaluation is dependent upon future development drilling in the area and that these numbers should be viewed with caution until the acreage has been developed.

As mentioned earlier, Czar will work towards maximizing the benefits to Canadian companies as set forth in the NEP. Although the legislation has not as yet been finalized, the Company believes it has the requisite 65% Canadian Ownership Rating to qualify for the maximum grants available under the Petroleum Incentives Program.

As Czar is in a non-taxable position, the incentive grants for exploration and development activities will be more beneficial than the earned depletion allowance which is scheduled to be phased out over a four year period and replaced by the grant program. The Company expects to receive some $4 million as a result of 1981 drilling activities.

United States

The operations of Czar's wholly owned United States subsidiary, Czar Resources, Inc. ("Czar, Inc."), provides a significant and ever increasing contribution to the growth of the consolidated company. Beginning in December, 1977 with three

employees in Houston, Texas, Czar, Inc. now has operational bases in Tulsa, Oklahoma and Denver, Colorado in addition to Houston. In the United States, there are over seventy employees on staff.

During the first six months of fiscal 1981, Czar, Inc. participated in the drilling of twenty-one wells of which three are currently drilling, two are producing oil wells and twelve are classified as potential oil or gas wells. Of particular importance is the M.G. Johnson #1 well located in Gonzales County, Texas. Although the well initially tested 1000 barrels of oil per day from the Austin Chalk, the deeper Buda formation was also considered to be of commercial value. The well was completed in this formation at a rate of 80 barrels of oil per day. Currently the Austin Chalk section is being perforated and production from this zone will be commingled with the Buda. Three additional Chalk wells, Ruddock B-1, Austin #1 and Cusak #1 have all tested in excess of 80 barrels of oil per day. To enhance deliverabilities, two of these wells are being fracture treated and are scheduled to be on stream producing oil by the end of June, 1981.

The Austin Chalk is a rather unconventional formation in that there is very little primary porosity in the rock. The majority of recent commercial reserves are related to what is known as fracturing with the oil being trapped along the fault zones. The Company uses a geophysical seismic technique to delineate these oil filled areas of fractured chalk. To date, incorporating this exploration concept, Czar, Inc. has drilled or participated in 30 Austin Chalk wells of which 13 are currently on stream and 11 are presently being completed and tied into production facilities. The producing wells are netting approximately 700 barrels of oil per day to Czar's, Inc. working interest and management estimates that Czar's, Inc. share will be increased by an additional 350 barrels of oil per day from the current round of completion activities.

As indicated above, the Austin Chalk remains an important exploration and production area for Czar, Inc., accounting for approximately 90 percent of the Company's present United States revenues. However, increasing emphasis is being placed on expansion in other areas such as the Rocky Mountain and Mid-Continent areas. In the Rocky Mountain area, Czar, Inc. has been generating additional prospects in the Williston and Southern Powder River Basins. Of particular interest is the Douglas Prospect in Wyoming, in which Czar, Inc. has accumulated 14,700 gross acres and 7,000 net acres. The acreage block is offset by a well drilled and completed by another operator, which tested gas in excess of 7 million cubic feet per day from the Frontier formation, with six additional potential oil and gas bearing formations penetrated prior to reaching total depth. Czar, Inc. has commenced its first well on this prospect.

In the Anadarko Basin of Oklahoma, Czar, Inc. over the past six months, successfully has participated in several wells. The initial phase of this program called for the drilling of ten wells. To date, three have been completed and placed on production, three are being completed, two are drilling and have either tested or have indicated gas pays on electric logs, and the remaining two are to be drilled in the last half of 1981. The initial productive horizon in the three completed wells, which are producing at rates ranging from 2 million cubic feet per day to 8 million cubic feet per day, is located below 15,000 feet which qualifies for a gas price of $6.75 (U.S.) per thousand cubic feet. While drilling the deep tests, gas was also encountered in several horizons between 9,000 and 15,000 feet. After completion of the first round of drilling, additional development drilling will be undertaken to maximize production. Czar, Inc. and its drilling fund partners have interests in these wells of up to 6 percent.

New prospect areas which are being generated by Czar's, Inc. Tulsa, Oklahoma exploration office include the Sooner Trend area where Czar, Inc. has accumulated 640 gross acres and 525 net acres. Excellent production results of up to 400 barrels of oil per day and 4.5 million cubic feet per day have been reported from wells drilled by other operators on land offsetting Czar's, Inc. acreage. Exploration is proposed to commence on this block in September, 1981.

Czar, Inc. is also continuing its activities in southern Louisiana with several closely controlled exploratory wells planned for 1981. An example of

the type of play being explored is the North Reeves prospect which resulted from the development of the Reeves prospect first drilled by Czar, Inc. in 1979. Production from two wells there are averaging 65 barrels of oil per day from a series of marine sands. The North Reeves prospect is expected to encounter similar producing horizons and drilling is expected to begin in July, 1981.

In addition, Czar, Inc. is generating exploration prospects in Montana, Colorado, New Mexico, Kansas and Texas.

production...

Canada

As mentioned in the Annual Report, the Company, its drilling funds and participating industry partners have agreed to sell on a best efforts basis 212 billion cubic feet of natural gas to Consolidated Gathering Systems Limited for final use by Sherritt Gordon Mines Limited at its fertilizer plant in Fort Saskatchewan.

During the period from November 1, 1980 to February, 1983, the Company has the opportunity to provide up to 8 million cubic feet per day of natural gas to Consolidated Gathering Systems Limited. At this time, 6.2 million cubic feet per day of natural gas is being sold. In February of 1983, the contract provides for the sale of 28 million cubic feet per day escalating to 30 million cubic feet per day by 1985. The price reflects a moderate discount from the Alberta field price with 100 percent of the export flowback adjustment going to the producers.

Czar expects that a substantial portion of the initial sales under this contract will come from the Parkland- Claresholm area some 50 miles south of Calgary where the Company presently holds an interest in nine gas wells which have proven deliverability rates in excess of 20 million cubic feet per day. These deliverabilities, combined with further planned drilling and other industry activities within the area, have indicated to the Czar engineers the economic viability of building a 30 million cubic feet per day gas processing plant. A plant site has been selected and application to the necessary regulatory bodies will be filed in the near future.

Also in Alberta, a solution gas dehydration and compression facility at Lanaway was placed on stream on June 4, 1981 to process 1.8 million cubic feet per day of solution gas from the Company's gross current oil production of 570 barrels per day. Czar's share of the gas volume is approximately 340 thousand cubic feet per day of gas.

Final approvals were received by Pro-Gas in mid June 1981 for a gas sales contract to the United States and production commenced on June 20th, 1981 at Medicine River. Of our five wells in the contract area, three are producing at the current nomination of 8.2 million cubic feet per day and 738 barrels of condensate. Czar's working interest in these wells is approximately 24 per cent.

As stated in the 1980 Annual Report, a gas sales contract was negotiated for two wells in the Petitot area. These wells produced a total of 455.6 million cubic feet at an average rate of three million cubic feet per day for a six month period. The wells are now shut-in until November as the contract calls for production over a six month winter period. Significantly, pressure studies conducted after the previous production period have illustrated up to 3150 acres of reservoir drainage from a single well.

During the 1980-81 winter season record monthly production was established for Czar interest wells in British Columbia. Monthly production rates reached as high as 1765 million cubic feet (56.9 million cubic feet per day) with a Czar share of 395.4 million cubic feet monthly (daily 12.75 million cubic feet). A

substantial portion of the sales gas came from the Monias area where, as a result of reserves redetermination, the Czar operated portion of the field produced as high as 20 million cubic feet per day during the month of November and average over 16 million cubic feet per day for the total winter period.

United States

Czar, Inc. operated 18 producing wells and had production from 13 non-operated wells during the first half of fiscal 1981. Gross production from these wells was 186,642 barrels of oil and 316 million cubic feet of gas. Net production to Czar, Inc. during this period totalled 112,050 barrels of oil and 63 million cubic feet of gas for an average of 615 barrels of oil per day and 348 thousand cubic feet of gas per day. Revenue from oil and gas production net to Czar, Inc. for the first six months of the fiscal year was $2,735,000. This represents an 800% increase from corresponding revenue credited to first half of the previous fiscal year. Eleven wells in which Czar, Inc. has varying interests are now being completed and management estimates they could add a net 350 barrels of oil per day to production during the latter part of the third quarter.

financial . . .

Management is pleased to announce that the maximum of $14 million (U.S.) has been raised for the first part of the Czar-Aurora 1981 Oil and Gas Program which will be expended in the United States in 1981 and 1982. Because of the successful completion of the first part, the second part, for $6 million (U.S.) will be accelerated to a mid July closing.

In addition to these funds, the Company has approximately $12 million (U.S.) from European investors for United States exploration.

In Canada, the Company and Aurora Energy Fund Ltd. have filed a preliminary prospectus for the issue of units of a new company, Aurora-Czar Energy Co. Ltd., which expects to raise up to $20 million for exploration in Canada over the next year. Limited partners in four Aurora-Czar partnerships will have the opportunity to exchange their units for tradeable common shares in the new company and cash subscribers will benefit from tax write-offs of exploration and development expenditures through the purchase of inventory shares. Cash subscribers will also receive Petroleum Incentive Program grants to the extent they are earned by exploration expenditures. Czar is also negotiating joint venture arrangements with private sources who wish to contribute to its exploration program.

Czar estimates gross revenue, net of operating expenses, in fiscal 1981 to be $15 million derived equally from Canadian and United States production. Although it is difficult to project Canadian revenues without a Federal-Provincial energy pricing agreement, Czar expects that increased activities in the United States, increased industrial gas sales in Canada and some strengthening of the pricing structure in British Columbia should generate revenues of $20 million in 1982 and substantially higher in 1983.

Since 1979 the Company has been developing significant large geological areas which are not expected to be productive for the next several years. Under the accounting policies which have been historically applied by the Company all interest expense on monies expended to develop these properties has been expensed when incurred. However, accounting principles provide that such interest costs may be capitalized as part of the cost of developing the properties.

The Company has changed its accounting policies in 1981 to capitalize such interest charges and remove the cost of these properties from the depletion base. The 1980 financial statements have been restated accordingly.

reserve evaluation . . .

Due primarily to the success of our 1980-81 winter drilling program and to a reappraisal of the economic factors used by our engineering consultants in determining the impact of the National Energy Program, the Company requested a new economic evaluation of Canadian reserves updated from October 31, 1980 to March 31, 1981.

The results of this evaluation are summarized in the following table:

	Net Reserves				Estimated Future Net Revenue	
	P&NG Liquids (000's bbls)		Natural Gas (MMcf)		Undiscounted	
Canada	Oct. 1980	March 1981	Oct. 1980	March 1981	Oct 1980	March 1981
(To March 31, 1981)						
Proved Developed	1,523.1	1,550.0	151,174.9	187,692.0	$551,925,879	$ 790,142,633
Probable	147.2	194.0	67,796.3	108,792.0	261,421,005	445,237,731
Total Canada	1,670.3	1,744.0	218,971.2	296,484.0	813,346,884	1,235,380,364
United States						
(To Oct 31, 1980)						
Proved Developed	856.9	856.9	1,469.7	1,469.7	41,228,927	41,228,927
Proved Undeveloped	554.8	554.8	974.0	974.0	24,656,692	24,656,692
Probable	4.2	4.2	423.3	423.3	3,952,195	3,952,195
Total U.S.A.	1,415.9	1,415.9	2,867.0	2,867.0	69,837,814	69,837,814
TOTAL	3,086.2	3,159.9	221,838.2	299,351.0	$883,184,698	$1,305,218,178

Discounted at 15% the Canadian revenue figures increased from $151,233,942 to $200,027,076 from October 31, 1980 to March 31, 1981, and at 20% from $106,356,856 to $134,843,056

We are extremely pleased with this increase in our Canadian reserve base and will now concentrate on employing these assets in Canada and the United States to generate a substantial cash flow.

Presented on behalf of the board of directors

R. W. Lamond,
Chairman & Chief Executive Officer

I. B. McMurtrie,
President & Chief Operating Officer

June 26, 1981

CZAR RESOURCES LTD.
CONSOLIDATED BALANCE SHEET AS AT APRIL 30, 1981
(Unaudited)

	1981	1980 (restated)
ASSETS		
CURRENT ASSETS		
Accounts receivable		
- trade	$ 10,842,023	$16,320,831
- drilling programs	16,819,720	3,175,468
Inventory of supplies at lower of cost or net realizable value	4,394,232	1,229,493
	32,055,975	20,725,792
FIXED ASSETS		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	112,097,164	50,650,573
Accumulated depletion and depreciation	4,943,303	1,974,667
	107,153,861	48,675,906
	$139,209,836	$69,401,698
LIABILITIES		
CURRENT LIABILITIES		
Bank indebtedness	$ 6,753,290	$16,018,741
Notes payable	8,981,500	—
Accounts payable and accrued liabilities	16,044,668	10,688,812
Drilling advances	485,905	200,000
	32,265,363	26,907,553
LONG TERM DEBT	40,400,000	—
DEFERRED INCOME TAXES	1,927,919	2,017,285
SHAREHOLDERS' EQUITY		
CAPITAL STOCK		
Authorized		
600,000 First Preference Shares with a par value of $25 each issuable in series		
15,000,000 Common Shares without nominal or par value		
Issued		
11,626,053 Common Shares (1980 - 9,589,869)	59,494,007	36,173,830
RETAINED EARNINGS	5,122,547	4,303,030
	64,616,554	40,476,860
	$139,209,836	$69,401,698

CZAR RESOURCES LTD.
CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS
(Unaudited)
Six Months Ended April 30, 1981

	1981	1980 (restated)
REVENUE		
Production	$6,203,921	$2,564,628
Less petroleum gas revenue tax	65,713	—
	6,138,208	2,564,628
Principal and interest from property dispositions	905,673	848,261
Management fees	79,055	120,320
Other	469,339	68,109
	7,592,275	3,601,318
EXPENSES		
Production	712,740	288,200
General and administrative	2,155,161	374,709
Interest on long term debt	552,191	223,514
Other interest	3,306,558	780,643
Interest capitalized	(1,073,582)	(201,549)
Depletion and depreciation	1,499,492	766,103
	7,152,560	2,231,620
EARNINGS BEFORE INCOME TAXES	439,715	1,369,698
INCOME TAXES		
Current	(32,099)	(17,670)
Deferred	210,459	614,848
	178,360	597,178
NET EARNINGS FOR THE PERIOD	261,355	772,520
Retained Earnings at beginning of period	4,861,192	3,680,457
Dividends on First Preference Shares, Series A	—	(149,947)
RETAINED EARNINGS AT END OF PERIOD	$5,122,547	$4,303,030
BASIC EARNINGS PER COMMON SHARE, after deduction of prescribed dividends on First Preference Shares, Series A	$.03	$.07

CZAR RESOURCES LTD.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
(Unaudited)
Six Months Ended April 30, 1981

	1981	1980 (restated)
WORKING CAPITAL DERIVED FROM:		
Operations		
Net earnings	$ 261,355	$ 772,520
Items not requiring working capital	1,709,951	1,380,951
	1,971,306	2,153,471
Long term debt	40,400,000	—
Issue of Common Shares for cash, net of share issue expenses	22,522,605	24,447,402
	64,893,911	26,600,873
WORKING CAPITAL APPLIED TO		
Fixed assets, net	31,583,049	23,039,161
Repayment of long term debt	—	2,916,667
First Preference Shares, Series A redeemed for cash	—	145,500
Dividends on First Preference Shares, Series A	—	149,947
	31,583,049	26,251,275
INCREASE IN WORKING CAPITAL POSITION	33,310,862	349,598
WORKING CAPITAL DEFICIENCY AT BEGINNING OF PERIOD	(33,520,250)	(6,531,359)
WORKING CAPITAL DEFICIENCY AT END OF PERIOD	$ (209,388)	$ (6,181,761)

Printed in Canada

AR44

This prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence.

New Issue:

CZAR RESOURCES LTD.

1,800,000 Common Shares

(without nominal or par value)
and

600,000 Common Share Purchase Warrants

Offered in Units, each Unit consisting of one Common Share and one-third of a Common Share Purchase Warrant.

Common Share Purchase Warrants

One Warrant will entitle the holder to purchase one Common Share at a price of $14.00 per share on or before September 30, 1982 and thereafter at a price of $17.00 per share on or before April 30, 1986. Warrants will be issued in bearer form on September 15, 1981 and until then will form an inseparable part of the Units.

In the opinion of counsel, the Common Shares will be eligible for investment under certain statutes as set forth under "Eligibility for Investment" on page 44.

PRICE: $13.00 per Unit

	Price to Public	Underwriting Commission	Proceeds to Company (1)
Per Unit.........	$ 13.00	$ .81	$ 12.19
Total............	$23,400,000	$1,458,000	$21,942,000

(1) Before deducting expenses of the issue estimated at $325,000.

The Common Shares of the Company are listed on the Alberta and Toronto Stock Exchanges. Application has been made to list the Common Shares on the Montreal Stock Exchange. Applications have also been made to list the Units on the Toronto, Montreal and Alberta Stock Exchanges until September 15, 1981 and thereafter to list the Common Share Purchase Warrants on such Exchanges separately from the Common Shares of the Company. Acceptance of each of the listings will be subject to the filing of required documents and evidence of satisfactory distribution, both within 90 days.

There are a number of risks associated with a purchase of Units. See "Risk Factors and Industry Conditions" on page 36.

We, as principals, conditionally offer these Units, subject to prior sale, if, as and when issued by the Company and accepted by us in accordance with the conditions contained in the Underwriting Agreement referred to under "Plan of Distribution" on page 26.

Subscriptions will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. It is expected that definitive certificates for the Units will be available for delivery on or about April 24, 1981.

April 4, 1981

This is a summary of the more detailed

SUMMARY

The Offering

The Issue: 1,800,000 Common Shares and 600,000 Common Share Purchase Warrants to be offered in Units at a price of $13.00 per Unit, each Unit consisting of one Common Share and one-third of a Common Share Purchase Warrant. See "Details of the Offering" on page 23 and "Plan of Distribution" on page 26.

Warrants: Until September 15, 1981, the Warrants will form a part of, and will not be separable from Common Shares forming part of, the Units. After that date Common Share certificates and Warrant certificates will be available separately to Unitholders.

One Warrant will entitle the holder to purchase one Common Share at a price of $14.00 per share on or before September 30, 1982 and thereafter at a price of $17.00 per share on or before April 30, 1986.

Use of Proceeds: The estimated net proceeds of $21,617,000 will be applied to reduce outstanding bank indebtedness in order to increase the cash flow available for the Company's continuing exploration and development program and to increase unused bank lines of credit. See "Use of Proceeds" on page 25 and "Exploration and Development Program" on page 17.

The Company

Business: The Company is in the business of exploring for, developing and producing petroleum and natural gas in western Canada and the United States. See "Business" on page 5.

Reserves: As at October 31, 1980, the Company's total reserves of oil and natural gas were, respectively, 67% and 21% higher than as at October 31, 1979.

The estimated future net revenues from the Company's reserves as at October 31, 1980 were as follows:

	Undiscounted	Discounted at 10%	Discounted at 15%	Discounted at 20%
Canada	$813,346,884	$234,014,007	$151,233,942	$106,356,856
United States	69,837,814	48,626,201	41,977,709	36,819,542
	$883,184,698	$282,640,208	$193,211,651	$143,176,398

Discounted at 15%, the estimated future net revenues have increased 41% since October 31, 1979. These calculations are made after the proposed petroleum and gas revenue tax but before income tax. See "Reserves" on page 10.

Production and Financial Data:

	12 months ended October 31 1980	1979
Revenue after royalties	$ 8,884,779	$ 4,722,186
Capital expenditures	$52,390,570	$16,267,359
Working capital from operations	$ 4,110,169	$ 3,328,013
Net earnings	$ 1,034,573	$ 1,454,864

See "Production Information" on page 13 and the Consolidated Financial Statements of the Company commencing on page 48.

Undeveloped Acreage: As at December 31, 1980 and October 31, 1980 the estimated replacement cost of the undeveloped land holdings (312,916 net acres and 972,906 gross acres in total) in Canada and the United States was $50,926,948 and $3,725,496, respectively. See "Undeveloped Acreage" on page 20.

Risk Factors: The petroleum industry is subject to a number of exploration, production and regulatory risks. See "Risk Factors and Industry Conditions" on page 36. The Company's position in the face of the proposed National Energy Program is set forth on page 34.

information contained elsewhere in this prospectus.

Recent and Proposed Activities of the Company

Canadian Activities

During fiscal 1980 the Company expended $38.7 million on its own behalf on exploration and development in Canada. The Company participated in the drilling of 135 wells located in northeast British Columbia and in central and southern Alberta.

Over the next two years the Company will concentrate its exploration and development activities on prospects likely to generate an early cash flow to the Company. To a lesser extent the Company will explore and develop prospects located in Petitot and in the Monias-Callisto-Boudreau area of British Columbia where cash flow may be delayed but where there is the potential of discovering reserves at a relatively low cost. However, the Company does not intend to dedicate any significant portion of its funds to these areas.

Should financing be available, the Company anticipates spending up to $30 million in Canada over the next two years on its own behalf and on behalf of drilling programs and may drill up to 100 wells.

The Company recently entered into an agreement to supply natural gas for Sherritt Gordon Mines Limited's planned ammonia manufacturing operation in Fort Saskatchewan, Alberta. This contract will allow the Company to sell up to 37 Mmcf per day by February, 1983 of its available natural gas in Alberta at prices which represent discounts from the average field price for natural gas. See "Sale of Production" on page 13.

United States Activities

As at October 31, 1979 the Company's U.S. oil and gas reserves accounted for approximately 1% of its total reserves. During fiscal 1980 the Company spent $13.2 million on its own behalf and $3.2 million on behalf of drilling programs and drilled 35 wells in the United States, with a success rate of 71%. By October 31, 1980 the Company had U.S. oil and gas reserves with estimated future net revenues therefrom, discounted at 15%, of more than $40 million. At this date, U.S. reserves accounted for 48% of the Company's estimated proved crude oil reserves and 2% of the Company's estimated proved natural gas reserves. See "Reserves" on page 10.

Czar anticipates spending up to $20 million in the United States in fiscal 1981 on its own behalf and on behalf of drilling programs. The Company will continue its exploration in the Austin Chalk trend in Texas where the Company has an interest in approximately 30,000 gross acres (10,000 net acres), has acted as operator in drilling and completing 10 producing oil wells, and where cash flow to the Company in January, 1981 amounted to $500,000 U.S. after royalties, Windfall Profit Tax and operating expense.

Other areas of activity in the United States in fiscal 1981 will include the Anadarko Basin of Oklahoma, the San Juan Basin of New Mexico and prospects in Montana.

Financing

During fiscal 1980, approximately $70 million was made available through various drilling programs for the Company's exploration and development activities in Canada and the United States of which a substantial portion was spent after fiscal 1980.

The Company has obtained or will obtain approximately $42 million from drilling program investors during fiscal 1981 of which approximately $18 million remains to be spent. Additional funds may be available to the Company but no assurance of this can be given. The Company estimates that its financial commitment in 1981 and early 1982 will be less than 10% of the unexpended funds which would be financed in part by the Company's increasing cash flow and its unused bank lines of credit.

Ownership

The Company is Canadian controlled and may have a Canadian ownership rating under the terms of the proposed National Energy Program in excess of 65%. As a result, the Company may be entitled to grants commencing in 1981. Because the legislation of the federal government has not yet been implemented, it is not known how much, if any, of the grants for which the Company will qualify. See "Petroleum Incentives Program" on page 40.

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Unless otherwise stipulated all amounts calculated in United States dollars have been translated into Canadian dollars on the basis that U.S. $1.00 = Cdn. $1.1655.

THE COMPANY

General

Czar Resources Ltd. was incorporated as a private company by Memorandum of Association under the laws of the Province of Alberta on April 11, 1974 and converted to a public company on July 5, 1975. The Company has two wholly-owned subsidiaries, Czar Developments Ltd. (an Alberta corporation) which operates in Canada, and Czar Resources Inc. ("Czar U.S.") (a Delaware corporation) which operates in the United States. In this prospectus, unless the context otherwise indicates, the "Company" and "Czar" refer to Czar Resources Ltd. and its subsidiaries.

The head office of the Company is located at 333 - 5th Avenue S.W. (10th floor), Calgary, Alberta T2P 3B6 and the head office in the United States is located at 333 North Belt, Suite 400, Houston, Texas 77060. The Company has an operations office in Fort St. John, British Columbia and Gonzales, Texas and has exploration offices in Denver, Colorado and Tulsa, Oklahoma.

Business

The Company is in the business of identifying and acquiring oil and gas prospects in western Canada and the United States and exploring for, developing and producing crude oil and natural gas in these areas.

At October 31, 1980 Canadian reserves accounted for 98% of the Company's estimated proved natural gas reserves and 52% of the Company's estimated proved crude oil reserves. Most of the Company's Canadian drilling activities are conducted on prospects located in northeastern British Columbia and in south and central Alberta.

The Company began operations in the United States in 1977. Since then an increasing emphasis has been placed on U.S. activities. In 1980 these operations contributed 28.8% and 24.8% of the Company's revenue and net earnings, respectively. In the Company's opinion it is reasonable to anticipate greater economic returns from oil and gas exploration activities in the United States than in Canada. Therefore, further increases in the Company's activities in the United States are expected during 1981 relative to its Canadian operations. Approximately 50% of the Company's projected capital expenditures for the year ending October 31, 1981, including capital expenditures on behalf of drilling programs, will relate to activities in the United States. Its activities in the United States are expected to be primarily concentrated in the Gulf Coast areas of Texas and Louisiana and to a lesser extent in New Mexico, Oklahoma, Kansas, Arkansas and Montana.

To October 31, 1980 the Company, on behalf of itself and its drilling programs, had expended approximately $165.4 million on exploration and development in western Canada and the United States. It is anticipated that during the 1981 fiscal year the capital expenditures which the Company intends or is required to make to generate and acquire prospects and to explore for and develop oil and natural gas will exceed the expected revenue from operations. Accordingly, the Company's exploration and development program will depend on the availability of external sources of financing.

The Company has conducted a majority of its exploration and development activities through joint ventures with limited partnerships or corporations, or as a general partner of limited partnerships (collectively, the "drilling programs"). Under its arrangements with each drilling program, upon selecting properties which, in the Company's opinion, merit exploration and development as oil and gas prospects, the Company is required to offer varying interests in such prospects to the drilling program. The Company operates the prospect and receives a share of the revenues from the prospect, generally pays a proportionate share of any production facility costs after a well on the prospect is determined to be capable of commercial production, and in certain instances is required to contribute a portion of the drilling costs applicable to the prospect interest. See "Drilling Programs".

Operations

The basic exploration philosophy of the Company is to generate geological prospects in areas selected for their potential for hydrocarbons, proximity to pipelines and ease of access; to acquire interests in petro-

leum and natural gas rights through farmin or purchase; and to finance a substantial portion of the cost of exploration and development drilling through the use of funds from drilling programs, thereby reducing the Company's risk in drilling operations.

The Company concentrates its operations in selected geographical areas in which its personnel have developed a familiarity with local geology and engineering, completion and production techniques. Most of the areas in which the Company operates are selected because of the geological likelihood of having multiple reservoirs which are prospectively oil and gas bearing, thereby minimizing risk.

The Company now participates directly in the cost of substantially all wells drilled by it on prospects where direct participation is available. To October 31, 1980 Czar had expended an aggregate of approximately $63.8 million of its own funds on exploration and development activities in Canada. As of October 31, 1980, the Company's interests in estimated reserves located in Canada were 219.0 Bcf of natural gas and 1,670.3 thousand Bbls of petroleum and natural gas liquids. See "Reserves".

Since the Company established an office in Houston in December, 1977, it has expended more than $15.7 million of its own funds on exploration and development activities in the United States to October 31, 1980 principally in the Gulf Coast areas of Texas and Louisiana. The Company's staff currently generates approximately 50% of the prospects the Company acquires. Although the risk of drilling non-productive wells in the United States is higher than in western Canada and it is difficult to assemble large blocks of land, the Company's experience has been that reserves, if discovered, are in greater demand than in Canada and the price available for the product is considerably higher. As of October 31, 1980, the Company's estimated reserves located in the United States were 2.4 Bcf of natural gas and 1,411.7 thousands Bbls of petroleum and natural gas liquids. See "Reserves".

Drilling Activities

During the five fiscal years ended October 31, 1980 and the first quarter of fiscal 1981 the Company drilled or participated in drilling wells as follows:

Fiscal Year Ended October 31	Gas Wells	Oil Wells	Dry Holes	Total
1976	12	11	7	30
1977	33	11	10	54
1978	40	17	36	93
1979	74	23	14	111
1980	66	49	55	170
First Quarter, January 31, 1981	25	12	13	50

NOTE:

The classification of some of the wells in the table does not exactly correspond to the classification of wells set out under "Productive Properties" on page 7 since this table classifies certain wells as "Gas Wells" or "Oil Wells" which the Company has cased as potentially hydrocarbon bearing based on available geological data but without actually testing hydrocarbons in all cases. Without test or completion data, engineering evaluations as to proven or probable reserves have not as yet been conducted and such wells are not included in the evaluation reports referred to under "Reserves".

The Company's share of costs of land acquisition, exploration and development drilling and equipment and production facilities for the five fiscal years ended October 31, 1980 was as follows:

Fiscal Year Ended October 31	Land Acquisition (1)	Exploration and Development Drilling (2)	Equipment and Production Facilities
1976	$ 564,278	$ 13,980	$ 739,830
1977	1,720,239	526,263	1,981,184
1978	174,042	1,896,441	3,364,875
1979	4,589,839	8,618,315	2,745,389
1980	16,107,144	27,780,506	8,065,002

NOTES.

(1) The cost of land acquisition to the Company in each year has been netted against any recoveries from drilling programs for land sold to them in that year.

(2) Net of recovery of costs pursuant to the Copetrex agreements. See "Drilling Programs — Copetrex".

(3) In addition to the capital expenditures shown above, the Company also spent $86.5 million on these capital items on behalf of drilling programs with which it participated.

PRODUCTIVE PROPERTIES

The Company's oil and gas wells to October 31, 1980 are listed by area and in the case of the principal properties by locality in the following table. Wells listed as "capped" are wells which the Company considers capable of production.

	Gross Wells (1)	Net Wells (1)	Status		Proximity To Pipelines in Miles
			Producing	Capped (2)	
Canada: Gas Wells					
Alberta					
Sylvan Lake	4	1.87	2	2	2
Medicine River	6	1.64	1	5	4
Gadsby	8	3.66	2	6	3
Parkland-Claresholm	8	1.33	1	7	2 - 30
Hussar	21	5.83	11	10	4
Leahurst	5	2.69	4	1	1
Others	66	18.42	6	60	—
British Columbia					
Monias	16	3.96	7	9	1
Fireweed	7	2.10	3	4	2
Helmet-Petitot	14	3.71	2	12	8 - 30
Birch	11	3.53	7	4	1
Others	43	11.70	15	28	—
Canada: Oil Wells					
Alberta					
Lanaway	7	1.16	6	1	—
Davey Lake	6	1.15	6	—	—
Twining	12	3.18	12	—	—
Pearce	6	2.01	4	2	—
Others	29	6.49	27	2	—
British Columbia	2	.8	2	—	—
United States: Gas Wells					
Texas	6	.47	5	1	2
Louisiana	2	.38	2	—	—
Oklahoma	1	.02	—	1	2
Montana	2	1.00	—	2	2
United States: Oil Wells					
Texas					
Austin Chalk Trend	15	7.63	12	3	—
Other	2	.69	1	1	—
Louisiana	1	.28	1	—	—

NOTES:

(1) The term "gross wells" means the total number of wells in which the Company has an interest. "Net wells" means the sum of the Company's net interests and working interests in the gross wells, in each case before "payout" where payout has not yet occurred. "Payout" is the point at which the costs incurred in respect of the well have been recovered by the party who incurred these costs. In cases where the Company incurred the costs, its net well interest may decrease after payout, normally by 50% of its interest before payout. Conversely, if the Company did not incur the drilling costs, its net well interest may increase upon payout. The "net wells" calculation includes the net revenue interests of the Company payable by the Copetrex drilling programs. See "Drilling Programs — Copetrex".

(2) See "Risk Factors and Industry Conditions".

PRINCIPAL PRODUCING PROPERTIES

The following table summarizes the interest in net reserves for the principal producing properties of the Company as at October 31, 1980, derived with respect to Canadian reserves from a report dated January 9, 1981 by John Blain Engineering Ltd., Calgary, Alberta and with respect to United States reserves from a report dated December 30, 1980 by B. P. Huddleston & Co., Inc., Houston, Texas. The table also illustrates the Company's production of crude oil, natural gas liquids and natural gas from Company operated and non-operated wells for the principal producing properties during the 1980 fiscal year of the Company:

	Net Reserves (1)		Production for Fiscal Year Ended October 31, 1980 (2)		
	Petroleum and Natural Gas Liquids (thousands of Bbls)	Natural Gas (Mmcf)	Petroleum and Natural Gas Liquids (Bbls)	Natural Gas (Mmcf)	Revenue ($)
Canada: Gas Wells					
Alberta					
Sylvan Lake					
Proved Developed	2.0	4,646.2			
Probable	—	895.1			
Total	2.0	5,541.3	442	154.3	458,294
Medicine River					
Proved Developed	210.7	6,890.9			
Probable	14.0	—			
Total	224.7	6,890.9	366	—	(3,321)
Gadsby					
Proved Developed	—	3,477.5			
Probable	—	2,314.8			
Total	—	5,792.3	15	—	(105)
Parkland-Claresholm					
Proved Developed	39.9	4,167.3			
Probable	—	145.7			
Total	39.9	4,313.0	—	—	—
Hussar					
Proved Developed	—	4,316.7			
Proved Undeveloped	—	410.6			
Probable	—	376.4			
Total	—	5,103.7	1,047	176.2	398,973
Leahurst					
Proved Developed	22.6	4,215.2			
Probable	—	459.9			
Total	22.6	4,675.1	—	—	—
British Columbia					
Monias					
Proved Developed	—	41,688.9			
Probable	—	21,483.8			
Total	—	63,172.7	—	511.8	982,081

	Net Reserves (1)		Production for Fiscal Year Ended October 31, 1980 (2)		
	Petroleum and Natural Gas Liquids (thousands of Bbls)	Natural Gas (Mmcf)	Petroleum and Natural Gas Liquids (Bbls)	Natural Gas (Mmcf)	Revenue ($)
Fireweed					
Proved Developed	—	12,428.7	1,048	253.7	460,298
Helmet-Petitot					
Proved Developed	—	4,864.5			
Probable	—	3,871.8			
Total	—	8,736.3	—	7.5	11,230
Birch					
Proved Developed	2.3	14,638.2			
Proved Undeveloped	—	748.7			
Probable	—	655.9			
Total	2.3	16,042.8	1,115	357.8	446,490
Canada: Oil Wells					
Alberta					
Lanaway					
Proved Developed	195.2	2,326.7			
Probable	19.0	—			
Total	214.2	2,326.7	18,521	—	226,250
Davey Lake					
Proved Developed	102.8	—			
Probable	—	367.2			
Total	102.8	367.2	8,278	9.0	101,661
Twining					
Proved Developed	349.3	1,174.1			
Probable	—	359.7			
Total	349.3	1,533.8	31,872	107.4	621,914
Pearce					
Proved Developed	135.2	—			
Probable	9.5	—			
Total	144.7	—	7,636	—	83,215
United States: Oil Wells					
Texas					
Austin Chalk Trend					
Proved Developed	725.7	—	91,800	7.6	1,880,180

NOTES:

(1) The information set forth in the columns under "Net Reserves" is a portion of the total reserves of the Company as more fully set forth under the heading "Reserves" and should be read in conjunction with the information set forth under such heading.

(2) The information set forth comprises a portion of the Company's production as more fully described under the heading "Production Information" and should be read in conjunction with the information under such heading.

RESERVES

The following table summarizes the interest in net reserves and estimated future net revenues of the Company by way of its working interests and its net revenue interests in oil and gas properties as at October 31, 1980, derived with respect to Canadian reserves from a report dated January 9, 1981 by John Blain Engineering Ltd. ("Blain"), Calgary, Alberta and with respect to United States reserves from a report dated December 30, 1980 by B. P. Huddleston & Co., Inc. ("Huddleston"), Houston, Texas.

	Net Reserves		Estimated Future Net Revenues			
				Discounted		
	Petroleum and Natural Gas Liquids (thousands of Bbls)	Natural Gas (Mmcf)	Undiscounted	10%	15%	20%
Canada (1)						
Proved Developed....	1,523.1	150,015.6	$547,631,595	$170,420,707	$114,215,863	$ 82,962,579
Proved Undeveloped .	—	1,159.3	4,294,284	1,004,748	566,190	341,743
Probable	147.2	67,796.3	261,421,005	62,588,552	36,451,889	23,052,534
Total................	1,670.3	218,971.2	$813,346,884	$234,014,007	$151,233,942	$106,356,856
United States (2)						
Proved Developed....	856.9	1,469.7	$ 41,228,927	$ 29,773,356	$ 26,179,954	$ 23,386,498
Proved Undeveloped .	554.8	974.0	24,656,692	16,673,232	14,047,589	11,988,207
Probable	4.2	423.3	3,952,195	2,179,613	1,750,166	1,444,837
Total................	1,415.9	2,867.0	$ 69,837,814	$ 48,626,201	$ 41,977,709	$ 36,819,542
Total	3,086.2	221,838.2	$883,184,698	$282,640,208	$193,211,651	$143,176,398

The discounted future net revenue values are based upon estimates only, at rates of 10%, 15% and 20% per annum, compounded annually to mid-year, are prior to the consideration of indirect costs such as administrative overhead, miscellaneous expenses and income taxes and are not to be construed as representing the fair market value of the properties. These net revenue calculations should not be construed as representing the fair market values of the properties because the fair market values of the properties and such net revenues will depend to a large extent upon the subjective considerations of a particular purchaser.

The future undiscounted net revenue figure shown above for the Company's Canadian reserves has been prepared by Blain using available geological and production data supplied by the Company, data on file with public agencies and data in Blain's files. Blain has not inspected the Company's properties, has not conducted independent well tests and has not otherwise verified the data supplied by the Company. However, Blain has stated that it has no reasonable grounds to believe and does not believe that the data supplied by the Company is inaccurate for the purpose of calculating an undiscounted future net revenue figure in respect to the Company's Canadian reserves.

The future undiscounted net revenue figure shown above for the Company's United States reserves has been prepared by Huddleston using available geophysical, geological and production data supplied by the Company, and applying engineering and reserve criteria from Huddleston's files. In some cases the geological interpretations submitted by the Company were accepted by Huddleston as reasonable and in other cases the Company has submitted logging surveys, core analysis, well tests and other factual data necessary for making geological interpretations. Huddleston has generally tested the validity of the data from the Company as to ownership, product prices and other factual data.

The utility to investors of the undiscounted future net revenue figures calculated by Blain and Huddleston in respect of the Company's Canadian reserves and United States reserves is in large measure dependent upon the accuracy and reasonableness of such data.

The undiscounted future net revenue figures calculated by Blain and Huddleston from the data supplied reflect certain estimates, classifications, recognitions, assumptions and projections applied by Blain and Huddleston in the course of making the calculations. Thus the undiscounted future net revenue figures are based in part upon:

(1) estimates of reserve quantities;

(2) classifications of reserve quantities as proved, proved undeveloped or probable reserves;

(3) recognition of uncertainties concerning ultimate recoveries from probable reserves;

(4) assumptions concerning future production timing;

(5) projections of future selling prices for oil, gas and natural gas liquids;

(6) recognition of ownership interests;

(7) assumptions concerning future proposed petroleum and gas revenue tax ("PGRT") rates and provincial royalty rates in Canada;

(8) projections of future capital costs; and

(9) projections of future direct operating costs (excluding future indirect costs such as administrative overhead and miscellaneous expenses and excluding provision for income taxes both current and deferred).

With respect to these and other matters Blain and Huddleston have advised as follows in their reports:

(1) Canadian Reserves

(a) All estimates of future net revenue include principal and interest payments on amounts owing to Czar pursuant to the agreements with Copetrex Oil & Gas Co. Ltd. ("Copetrex") and are after deduction for applicable royalties, direct taxes, operating costs and future development costs. Such development costs were estimated at $11,308,580. Of this amount, Blain estimated that $551,030 and $1,850,317 will be spent by the Company in fiscal 1981 and 1982, respectively. See "Drilling Programs — Copetrex". The net revenue interests have been treated as equivalent working interests with the exception that the allotment of drilling and completion costs has been adjusted to reflect the agreements with Copetrex. Indirect costs such as administrative overhead, miscellaneous expenses and income taxes have not been considered.

(b) The following reserve classifications have been used by Blain in preparing its report:

"Proved Reserves" are the estimated economically recoverable quantities of crude oil or gas to be recovered from the Company's acreage. The existence of these reserves is based on engineering and geological data and the producibility of the reserves has been demonstrated by either flow tests, periods of production or by analogy with offset producing wells. "Probable Reserves" are additional reserves which are estimated to be recoverable through either additional drilling or increased recovery above that considered proved. "Probable Reserves" may be the reserves contained in existing wells whose producibility has not definitely been confirmed. The estimates of "Probable Reserves" are based on a realistic interpretation of the geological and engineering data available.

Whereas "Proved Developed Reserves" are those proved reserves which will be produced from existing wells or facilities, "Proved Undeveloped Reserves" are those which are not recoverable from existing wells or facilities or from those zones in existing wells which have been cased, but which can be recovered through the drilling of additional wells.

(c) The following price escalations have been used by Blain in its evaluation of Canadian reserves. These prices are net wellhead prices after removal of any direct taxes to be imposed by the federal government:

(i) For petroleum and natural gas liquids the price per barrel is $16.75 increasing to $18.25 in 1981, by $2.00 per year to $22.25 in 1983, by $4.00 in 1984 to $26.25, by $4.50 per year to $53.25 in 1990 and by 5% per year to $110.70 in 2005;

(ii) For Alberta natural gas the price per Mcf is $2.60 in 1980 and 1981, increasing by 20¢ in 1982 to $2.80, by 30¢ in 1983 to $3.10, by 40¢ in 1984 to $3.50, by 45¢ per year to $6.20 in 1990 and by 5% per year to $12.89 in 2005;

(iii) For British Columbia natural gas the price per Mcf is $1.22 in 1980, increasing by 20¢ per year to $3.22 in 1990 and by 5% per year to $6.69 in 2005; and

(iv) Operating costs have been increased by 7% per year for 10 years to 1990 and by 4% per year thereafter.

The price escalations used by Blain are not the same as those disclosed in the proposed National Energy Program by the federal government. Commencing in 1985, the price escalations used by Blain are significantly lower than those disclosed in the proposed National Energy Program by the federal government.

The federal government has initially set the proposed PGRT at 8% of net operating revenues relating to the production of oil and gas. The PGRT has been deducted from production revenues. The federal government has indicated in the proposed National Energy Program tabled with the budget of October 28, 1980 that when price increases occur in the price of oil and natural gas faster than $1.00 per barrel every six months, it will be necessary to review the PGRT. In the opinion of Blain the federal government does not intend that the full benefit of price increases will reach the hands of the producer. In Blain's estimation it would be reasonable to anticipate increases in the PGRT.

In order to compensate for these anticipated increases in the PGRT, Blain has reduced the prices which Blain would otherwise assume would be appropriate for petroleum and natural gas over the relevant period. In Blain's opinion, the reduction in prices which Blain made compensates for the impact of anticipated increases in the PGRT.

In Blain's report, operating costs are based on actual costs or have been estimated by comparison with actual costs from similar properties; capital costs have been included to complete, equip and tie-in wells where applicable; future capital expenditures have been escalated similarly to operating costs.

(d) Czar recently signed a gas dedication contract with Consolidated Gathering Systems Limited and Sherritt Gordon Mines Limited for the dedication of up to approximately 212 billion cubic feet of natural gas and contemplates the sale of at least 75% of this amount. See "Sale of Production". For the purpose of the Blain report it has been assumed that most of the uncontracted gas wells drilled in southern Alberta will be placed on stream under the contract.

(e) In view of the present Canadian gas marketing situation and the large proportion of reserves included in Canadian wells which have not been placed on production or have not as yet been completed and production tested, historical data with regard to the performance of certain wells is not available and the Blain report must be considered as only a preliminary appraisal of these wells. It should also be noted that, while some of the probable reserves were scheduled to commence production soon after the proved reserves in certain wells, the start year may be deferred for many years until depletion of the proved reserves in the same well. Therefore caution must be exercised in the application of the probable reserves in the Blain report. The Blain report is a summary of the results of individual net revenue projections prepared for each property. The complete report presents these net revenue forecasts along with a discussion of reservoir and production data.

(2) United States Reserves

(a) The following reserve classifications have been used by Huddleston in preparing its report:

"Proved Reserves" are those quantities of crude oil, natural gas and natural gas liquids which, upon analysis of geologic and engineering data, appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. "Proved Reserves" are limited to those quantities of oil and gas which can be expected, with little doubt, to be recoverable commercially at current prices and costs, under existing regulatory practices and with existing conventional equipment and operating methods. Depending upon their status of development, "Proved Reserves" are subdivided into "Proved Developed Reserves" and "Proved Undeveloped Reserves".

"Proved Developed Reserves" are proved reserves which can be expected to be recovered through existing wells with existing equipment and operating methods. This classification includes:

(i) "Proved Developed Producing Reserves". These are proved developed reserves which are expected to be produced from existing completion intervals now open for production in existing wells; and

(ii) "Proved Developed Nonproducing Reserves". These are proved developed reserves which exist behind the casing of existing wells, or at minor depths below the present bottom of such wells, which are expected to be produced through these wells in the predictable future, where the cost of making such oil and gas available for production should be relatively small compared to the cost of a new well.

Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery are included as "Proved Developed Reserves" only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

"Proved Undeveloped Reserves" are proved reserves which are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units, which are reasonably certain of production when drilled. "Proved Reserves" for other undrilled units are claimed only where it can be demonstrated with certainty that there is continuity of production from an existing productive formation.

(b) The following are the average product prices weighted as a composite for all properties as used by Huddleston. In these prices an 8% annual escalation factor has been used on a lease by lease basis to a maximum of U.S. $60.00 per barrel (before deducting Windfall Profit Tax) and U.S. $10.00 per Mmbtu of gas for ten years, whichever occurred first.

	Oil, $/Bbl (U.S.)	**Gas, $/Mmbtu (U.S.)**
First Year — 1980	$33.32	$2.73
— 1981	37.63	2.78
Maximum	51.75	7.98
Average Over Life	44.80	3.80

(c) Operating expenses were derived from Czar U.S. profit-loss statements for each lease and adjusted for non-recurring costs where applicable and from comparable producing properties for those wells that have not produced. Severance and ad valorem taxes have been calculated as a percent of gross revenues and were deducted by Huddleston as an operating expense. These costs were escalated 8% per year for ten years and held constant thereafter.

(d) Huddleston has deducted from the estimated future net revenues of the Company from its United States reserves drilling costs estimated at $2,367,895 U.S., of which $876,216 U.S. were estimated to be spent in fiscal 1981 and $1,485,746 U.S. in fiscal 1982.

(e) Cumulative production for all properties was approximately 4% of the estimated ultimate reserves as of October 31, 1980. Due to the lack of production histories, volumetric calculations and analogy to nearby production were utilized as the primary methods to estimate reserves. It is not unusual for estimates at this stage of depletion to be subject to greater variations than estimates prepared with the benefit of longer production histories. For the escalated product prices, the costs were equivalent to 28% of the gross revenues over life.

(f) Values were not assigned to nonproducing acreage and to the salvage value of surface and subsurface equipment. The costs to plug and abandon wells, general office overhead costs, federal income taxes and allowances for depreciation, depletion and amortization have not been deducted from estimated future net revenues.

(g) The estimates for individual leases should be considered in context with the overall or total estimated revenue. Actual individual lease performances will vary considerably from the projections, particularly in comparison to the total composite production from all properties. Huddleston has stated that it did not inspect the properties nor conduct independent well tests. Ownership and product prices and other factual data were accepted as represented by Czar U.S. Huddleston has stated that it generally tested the validity of these data and believes the information is correct.

The estimated future net revenues from the Company's United States reserves have been translated into Canadian dollars on the basis that U.S. $1.00 = Cdn $1.1655.

PRODUCTION INFORMATION

During the five fiscal years ended October 31, 1980, the Company's production of crude oil, natural gas liquids and natural gas from Company operated and non-operated wells was as follows:

Canadian Production Year Ended October 31	Crude Oil and Natural Gas Liquids (Bbls)	Natural Gas (Mcf)	Revenue
1976	9,136	533,041	$ 253,483
1977	40,420	1,527,409	1,354,079
1978	69,500	2,057,639	2,197,382
1979	74,185	3,518,434	3,814,335
1980	120,729	3,832,062	4,914,776
	313,970	11,468,585	$12,534,055
United States Production Year Ended October 31			
1978	179	12,131	$ 69,473
1979	6,622	28,294	175,670
1980	68,519	39,413	2,276,238
	75,320	79,838	$ 2,521,381
TOTAL	389,290	11,548,423	$15,055,436

NOTE:

The interests of the Company include the Company's share of revenue from production from prospects acquired by limited partnerships of which Copetrex Oil & Gas Ltd. is the general partner, as well as the principal and interest payable with respect to property dispositions, after deductions of production expenses, where the amount of such payments is measured by production revenue. Reference is made to "Drilling Programs — Copetrex" and to the Consolidated Statement of Earnings of the Company.

SALE OF PRODUCTION

Canada

The Company has an interest in a total of 66 producing gas wells and 60 producing oil wells in Canada, of which 34 gas wells and 2 oil wells are located in northeastern British Columbia. The most significant properties in this area are the Monias, Birch and Fireweed properties. Based on results of production obtained during fiscal 1980, these properties accounted for approximately 13.7%, 6.2% and 6.4%, respectively, of the revenue of the Company from production and from principal and interest from property dispositions. In Alberta, the primary producing properties are located in the Twining area of central Alberta where the Company has an interest in 12 producing oil wells and in the Hussar area of southern Alberta where the Company has an interest in 21 gas wells, 11 of which are producing. Based on results of production obtained during fiscal 1980 the Twining and Hussar areas accounted for approximately 8.6% and 5.6%, respectively, of the revenue of the Company from production and from principal and interest from property dispositions.

The Company has entered into an agreement (the "Dedication Agreement") dated as of July 31, 1980 with Consolidated Gathering Systems Limited ("CGSL") and Sherritt Gordon Mines Limited ("Sherritt") to sell to CGSL, for delivery to Sherritt, the volumes of natural gas required by Sherritt for its planned ammonia manufacturing operation in Fort Saskatchewan, Alberta. The operation is planned to commence on February 1, 1983.

The Dedication Agreement provides for the dedication by the Company of natural gas produced by it and joint venture participants who agree to participate in the sale, from properties located in Alberta south of Township 39 (the "contract area"). The volumes of natural gas to be dedicated and held available for purchase by CGSL are 37 Mmcf per day for the period from February 1, 1983 to October 31, 1984 and 40 Mmcf per day from then until October 31, 1997. When gas sales purchase contracts are executed by the Company and its joint venture participants in respect to dedicated reserves, CGSL will have the obligation to take and pay for, or pay for, in each year no less than 75% of the volumes required to be dedicated in that year. If upon the termination of any of the gas purchase contracts, CGSL has paid for any gas which it has not received, the excess amount paid by CGSL is to be repaid, together with interest, over a period of 12 years commencing no later than the first date upon which the Company or other sellers sell gas from the dedicated but undelivered volumes. The Company and the other joint venture participants must pay interest, compounded annually, at a rate equal to the rate charged by the Company's bank in Calgary plus 1%, on such amounts to CGSL until the excess purchase price is repaid.

The price to be paid by CGSL for natural gas is the difference between a varying percentage of the base price and the amount of any interest charges at the rate referred to above which accrue pursuant to the take or pay provisions. The base price, which approximates the Alberta field gas price, is the Alberta border price for natural gas less the cost of transportation services. Until October 31, 1983 the applicable percentage under the gas purchase agreements is 70% of the base price. From November 1, 1983 to October 31, 1992 the applicable percentage will increase by 1% per year to 80% of the base price. The percentage will remain constant at this level for the period from November 1, 1992 to October 31, 1997. From then until October 31, 2002 (assuming CGSL exercises its option to extend the life of the Dedication Agreement) the percentage will be 85% of the base price. The Company and the various joint venture participants remain entitled to receive the gas export rebate which currently approximates 87¢ per Mcf of natural gas.

The obligation of the Company to dedicate natural gas, and the corresponding benefits of the gas purchase agreements, are presently shared by certain of the participants with the Company in its various joint venture operations. The Company is currently determining whether various of its other joint venture participants wish to share these obligations and benefits.

The Company has undertaken to exercise its best efforts to locate within the contract area and bring on stream, additional natural gas so that over the contract period at least 212 Bcf of deliverable natural gas are dedicated to CGSL by the Company and its joint venture participants. It is estimated that the Company's share of this obligation will be 15% to 20% or 32 Bcf to 42 Bcf of natural gas. The Company and various participants in joint ventures with the Company currently have proven and probable reserves of natural gas within the contract area of approximately 150 Bcf.

Under the Dedication Agreement, the Company has the obligation to install the necessary production facilities to bring the dedicated reserves on stream. The Company is attempting to negotiate a satisfactory basis for an agreement with pipeline construction companies whereby such companies will install the necessary production facilities and charge a through-put fee to the Company. If such agreements are not entered into, however, it will be necessary for the Company to incur these expenditures itself. In the report prepared by John Blain Engineering Ltd. which estimates the Company's Canadian reserves, the cost of bringing reserves into production for purposes of the Dedication Agreement has been taken into account in calculating the estimated future net revenue that may be derived from its Canadian reserves.

The Company and certain of its joint venture participants are currently selling to CGSL 6.8 Mmcf of natural gas per day at a price equal to that payable to the Company under the Dedication Agreement for the period from February 1, 1983 to October 31, 1983. The Company's share of this volume is approximately 2.5 Mmcf per day before payout of the various producing wells and 1.7 Mmcf per day after payout of such wells. The Company is currently completing agreements with certain of its joint venture participants which, when completed, will provide for the sale of this volume to CGSL on a take-or-pay basis for the interim period

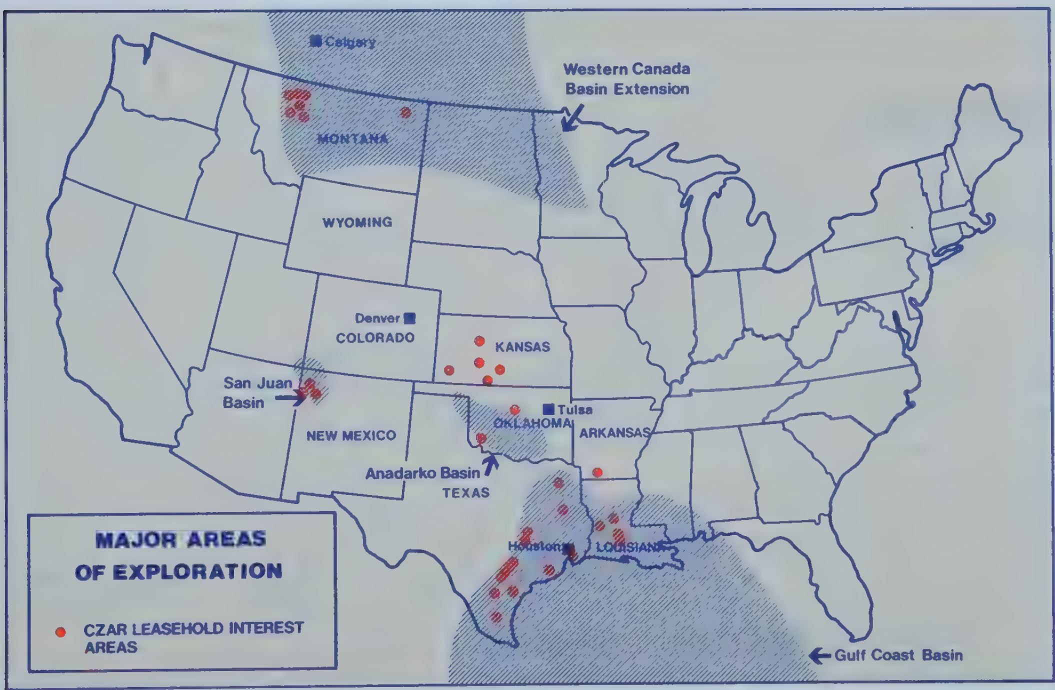
until February 1, 1983. CGSL has indicated to the Company that if additional natural gas is available, it may be prepared to purchase up to an aggregate of 8.9 Mmcf of gas per day during the interim period.

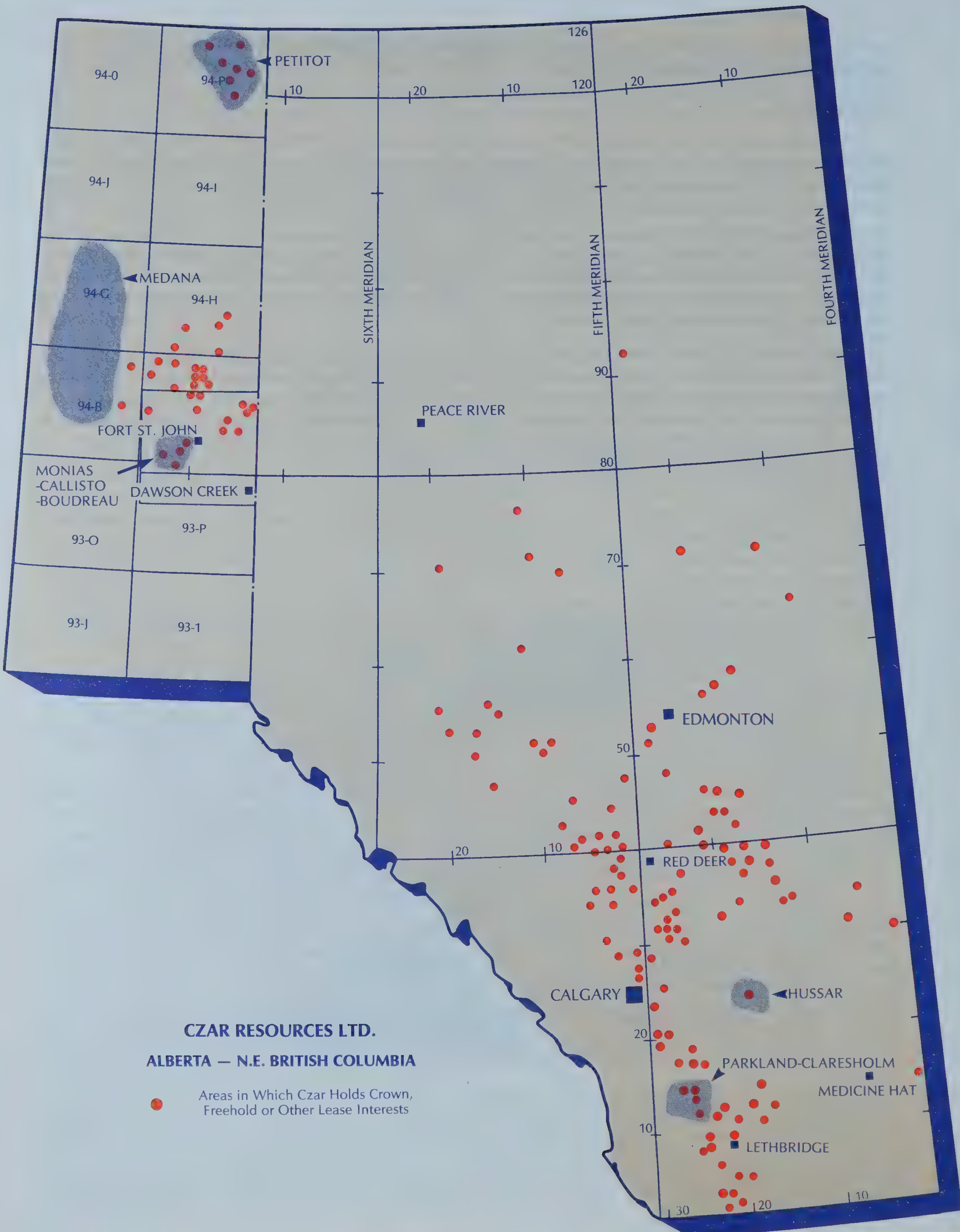
United States

The Company's primary United States producing properties are located in the Austin Chalk Trend of the Gulf Coast area of Texas where the Company has an interest in 12 producing oil wells and 10 wells which preliminary testing indicate may be prospectively oil bearing. These properties accounted for approximately 26.1% of the net production revenue of the Company during fiscal 1980.

Substantially all of the Company's oil production in the United States may be sold at world prices. The Company currently receives approximately $35 U.S. per barrel. All of the Company's contracts for the sale of oil in the United States can be terminated by the Company or by the purchaser on at least 30 days' notice. Therefore, under current market conditions characterized by rising prices for oil, the Company is in a position to take advantage of all price increases.

The Company's United States gas production is sold under seven gas sales contracts varying in length from five to twenty years. Prices available to the Company for this production are governed by federal regulations which establish classifications for wells and, for each classification, a maximum allowable price which a producer and purchaser may negotiate. In each of its contracts the Company has the right to receive the maximum allowable price for the particular category of well. Prices currently being received under these contracts range from $1.90 U.S. per Mcf to $2.52 U.S. per Mcf.

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FIFTH MERIDIAN
FOURTH MERIDIAN
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PEACE RIVER
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EDMONTON
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20
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RED DEER
CALGARY
HUSSAR
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PARKLAND-CLARESHOLM
MEDICINE HAT
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LETHBRIDGE
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CZAR RESOURCES LTD.
ALBERTA — N.E. BRITISH COLUMBIA
Areas in Which Czar Holds Crown, Freehold or Other Lease Interests

EXPLORATION AND DEVELOPMENT PROGRAM

The Company intends to conduct an exploration and development program so as to strengthen its cash flow, to explore, develop and earn acreage positions where large reserves are believed to exist and to build on its base of successful exploration in the United States, expanding and diversifying its U.S. drilling program in Texas, Oklahoma, New Mexico, Montana, Kansas and Arkansas.

Canadian Activities

The Company has offices in Calgary, Alberta and Fort St. John, British Columbia employing a staff of 74 persons including 41 professionals.

Until approximately the end of fiscal 1981, the Company intends to strengthen its cash flow by concentrating its activities on developing prospects with proven and probable oil reserves or with gas reserves that can be sold under its gas sales contracts. In addition, the Company intends to continue its exploration activities in areas where large reserves are believed to exist pursuant to arrangements that it is attempting to enter into whereby the Company will farmout a portion of its interest in certain lands in return for being carried through the exploration phase of the drilling. As a result, the Company intends to keep its expenditures on exploration and development activities in Canada to a relatively low level during the remainder of fiscal 1981. Thereafter, the Company intends to concentrate its activities on prospects likely to generate an early cash flow to the Company by making expenditures on exploration and development in areas prospective for oil reserves and where gas, when produced, can be sold under its gas sales contracts.

As part of this program, the Company intends to drill 4 wells in the Parkland-Claresholm area, southeast of Calgary, where the Company has interests in 8 gas wells with proven reserves and where additional gas reserves can be made part of the Dedication Agreement with CGSL and Sherritt. In the central Alberta areas of Manito-Leahurst, approximately 15 exploratory and development wells on discrete low risk prospects will be drilled within the Sherritt contract area.

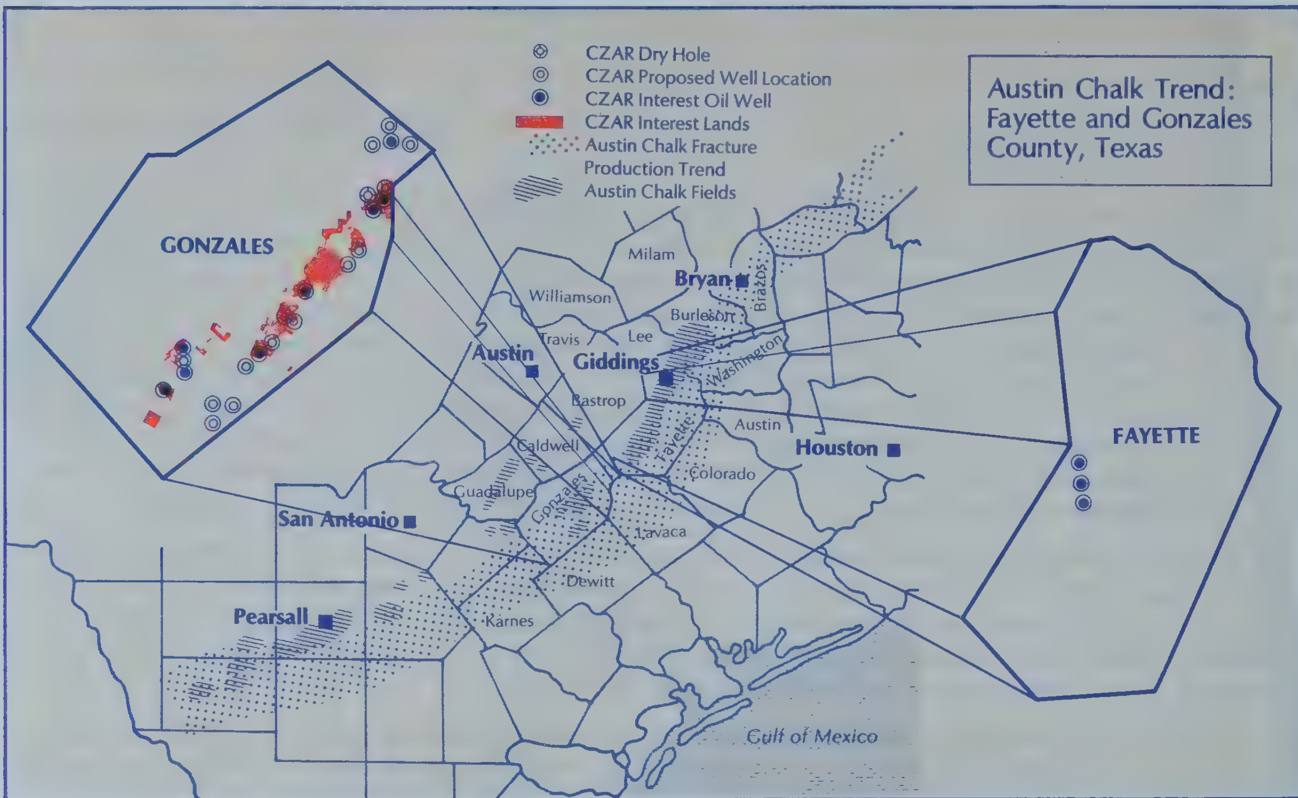
At Hussar, approximately 60 miles northeast of Parkland-Claresholm, the Company has an interest in 21 wells, 11 of which are producing, and plans an additional 6 wells to ensure maximum deliverability under the terms of an existing gas sales contract.

The Company will continue development drilling in the Monias-Callisto-Boudreau areas of northeast British Columbia near Fort St. John. In these areas, the Company has interests in 14 gas wells, 7 of which are currently on production. The Company may drill up to 4 development wells in these areas in fiscal 1981 which, if successful, may be included in the Company's existing gas sales contract when reservoir drainage can be proven pursuant to the recently approved British Columbia drainage regulations. Existing wells are currently being pressure monitored to prove that continuity of reservoir does in fact occur between the Callisto and Monias areas.

Activities by Czar and its industry participants over the last year have given rise to substantial increases in the asset base of the Company as a result of the discovery of new reservoirs. The Company feels that it is prudent to continue to drill for increased reserves (even though they may not be brought on stream in the immediate future) so as to preserve important acreage positions. An example of this is the Helmet-Petitot area in northern British Columbia where the Company has interests in approximately 231,000 gross acres (54,250 net acres) and the option to earn, by drilling, interests in a further 55,000 gross acres (12,650 net acres). The Company has drilled 38 wells to date with a success rate of 80%. John Blain Engineering Ltd., in its report referred to under "Reserves" relating to the Canadian reserves of the Company as at October 31, 1980, estimated that the Company's share, in the 21 wells drilled in this area to that date, of proven and probable gas reserves was 8736.3 Mmcf. The 17 wells drilled by the Company in this area since October 31, 1980 have not yet been evaluated by John Blain Engineering Ltd. However, geological and engineering data is consistent with the presence of a single gas reservoir. The Company does not intend to expend its own funds in this area because of anticipated delays in such properties being brought into production and will seek industry participation.

The Company believes a similar situation exists at Medana, northwest of Fort St. John, where the Company has drilled 2 wells during the 1981 drilling season and plans an additional 5 wells during the 1982 drilling season on a 150,000 acre block farmed in from Canadian Hunter Exploration Ltd.

The extent of the Company's drilling in any area will depend on the amount and the structure of the drilling funds made available to the Company for spending on behalf of its drilling programs. Should drilling funds be available, however, the Company together with these drilling programs may expend up to $30 million in Canada over the next two years and may drill up to 100 wells.



United States Activities

As indicated earlier, the Company commenced operations in the United States in 1977. Since then, the Company has substantially expanded its U.S. operations and now has exploration offices in Houston, Denver and Tulsa employing a staff of 50 persons including 27 professionals.

As at October 31, 1979 the Company's U.S. oil and gas reserves accounted for approximately 1% of its total reserves. During fiscal 1980 the Company spent $13.2 million on its own behalf and $3.2 million on behalf of drilling programs and drilled 35 wells in the United States with a success rate of 71%. By October 31, 1980 the Company had U.S. oil and gas reserves with estimated future net revenues therefrom, discounted at 15%, of more than $40 million. At this date, U.S. reserves accounted for 48% of the Company's estimated proved crude oil reserves and 2% of the Company's estimated proved natural gas reserves. See "Reserves".

The Company intends to continue to expand its exploration and development activities in the United States. In fiscal 1981, it will expend on such activities the uncommitted portion of the $20 million U.S. raised in 1980 by Europa Petroleum, Inc., one of the Company's United States joint venture participants. A registration statement was filed on February 10, 1981 with the United States Securities and Exchange Commission for a proposed public offering in the United States of up to $20 million U.S. of interests in two limited partnerships. However, no assurance can be given that any additional funds will be raised.

A primary focus of the Company's U.S. activities will be in the Austin Chalk trend of the Gulf Coast, particularly in Gonzales and Fayette counties of Texas. The Austin Chalk trend extends 350 miles from Mexico to East Texas along the hinge line of the Gulf Coast basin. Production from the trend is from secondary fracturing created by structural movement and associated faulting. Increased oil prices and technological changes in hydraulic fracturing plus the use of seismic to delineate the best location has resulted in the dril-

ling of over 800 wells in five counties. Czar recognized the potential of this prospect area in 1979 and has since acquired an interest in approximately 30,000 gross acres (approximately 10,000 net acres). Utilizing the technology developed in recent years, the Company has to date drilled, as operator, 10 wells in this trend, all of which have been completed as producing oil wells. It is estimated that these wells account for 1,000,000 Bbls or 32% of the Company's estimated crude oil reserves. Fourteen additional wells are currently being drilled or have been drilled in this area, ten of which have initially tested as prospectively oil bearing.

While there is a tendency for wells in the Austin Chalk trend to decline rapidly in production, the wells drilled by the Company, after suffering some initial decline, are now producing stable rates of flow ranging from approximately 50 Bbls to approximately 200 Bbls per day. Estimated undiscounted future net revenue as at October 31, 1980 attributed to the Company's share of its proven oil reserves in the Austin Chalk trend was estimated to be $43 million U.S. and the cash flow to the Company in January, 1981 from producing wells in the Austin Chalk trend amounted to $500,000 U.S. after royalties, Windfall Profit Tax and operating expenses.

The Company intends to participate in approximately 15 additional wells with other joint venture participants on this trend during fiscal 1981. While there can be no assurance that Czar's success rate in the Austin Chalk trend will continue, it is anticipated that the Company will drill in excess of 100 wells on its Austin Chalk acreage over the next 2½ years which, based upon industry drilling results in the Austin Chalk trend to date, could potentially increase Czar's future oil reserves in the Austin Chalk trend by approximately 5,000,000 Bbls or approximately 600%. The Company intends to finance a portion of its development activities in these wells through other joint venture industry participants which will result in a decrease in its net interest in these wells.

Other areas of activity in the United States include Oklahoma, New Mexico and Montana.

Czar U.S. is currently participating in a 9 well program in the Anadarko Basin of Oklahoma as a result of the estimated reserves assigned to wells previously drilled in this area (ranging from 20 Bcf to 50 Bcf per well) and a contracted gas price of $6.75 U.S. per Mcf. Further exploration during 1981 is planned for the Anadarko Basin and central Oklahoma.

In the San Juan Basin of New Mexico, Czar U.S. had acquired by the end of fiscal 1980 interests in approximately 15,000 gross acres (approximately 1,000 net acres) in order to test a geological formation similar in nature to the Austin Chalk trend in Texas. Czar has committed to drill 5 wells in this area, all of which will be completed by the end of fiscal 1981. If these drilling activities are successful, Czar U.S. estimates that it will drill an additional 60 wells in this area within the next five years.

In Montana, Czar U.S. has commenced the development of 7 prospects, 3 of which are believed to be extensions of tested geological formations known to exist in Alberta. Czar U.S. has drilled an exploratory well on one of the remaining two prospects and log and core analysis indicates the well to be productive. The Company has acquired 14,000 gross acres and 11,000 net acres in Montana.

Funding of Exploration and Development Expenditures

The Company will continue to conduct most of its exploration and development activities in fiscal 1981 through drilling programs with publicly and privately held limited partnerships and investors. By this means, the Company intends to manage a large expenditure program while keeping its own corporate expenditures to moderate levels and earning a share of net revenues of up to 20% more than its corporate share of the costs.

Drilling programs have made available, or will make available, to the Company during fiscal 1981, $42 million to conduct drilling activities in Canada and the United States. The Company's financial commitment with respect to $18 million, which remains unexpended, would be less than 10% of such amount. While there can be no assurance that additional funds will be raised from other drilling programs or similar ventures, the Company will not participate in raising additional funds from the public if to do so would result in the Company being unable to finance its obligations from its increasing cash flow or its unused bank lines of credit.

The Company intends, where possible, to concentrate its exploration and development expenditures on prospects likely to generate an early cash flow to the Company. The Company may also take advantage of opportunities which may arise from time to time to sell a portion of its properties to realize profits thereon, provided such sales can be made on terms considered attractive to the Company. The Company believes these policies will allow it to avoid an increase in its level of bank indebtedness.

UNDEVELOPED ACREAGE

The following table provides a breakdown of the Company's undeveloped gross and net acreage holdings by area as of October 31, 1980 for United States acreage and as at December 31, 1980 for Canadian acreage. The Company continues to hold virtually all of this acreage and has acquired additional acreage in the course of its continuing exploration program. The acreage set forth in the table includes all acreage held by the Company at such date excluding spacing units which had a producing well or a well capable of production located on it.

The undeveloped acreage of the Company in Canada as at December 31, 1980 had a replacement cost of approximately $50.9 million based upon a report dated January 14, 1981 prepared by Seaton-Jordan & Associates Ltd., land appraisers of Calgary, Alberta. Replacement cost is defined as the price which Seaton-Jordan & Associates Ltd. would recommend that a client bid at a Crown sale of leases of petroleum and natural gas rights.

The undeveloped acreage of the Company in the United States as at October 31, 1980 had a replacement cost as at January 15, 1981 of approximately $3.7 million based upon a report dated January 16, 1981 prepared by Kenneth W. Lane, land consultant, of Houston, Texas. Replacement cost is defined as the price which, based on the most recent acreage acquisition activity in the area in which Czar U.S. holds leasehold interests, Czar U.S. would be advised by Mr. Lane to pay in order to renew, at January 15, 1981, its current leasehold interest.

	Gross Acreage (1)	Net Acreage (1) (2)
Canada		
Alberta	512,069	180,302
British Columbia	377,105	104,412
	889,174	284,714
United States		
Louisiana	3,473	1,118
Texas	51,949	15,233
Montana	13,499	10,770
New Mexico	14,811	1,081
	83,732	28,202
TOTAL	972,906	312,916

NOTES:

(1) Gross acreage represents the acreage in which the Company has varying interests. Net acreage represents the aggregate of the interests of the Company (other than a royalty interest) in the gross acreage. In the case of reservations, permits and licences, these figures are after giving effect to future reversions to the government involved. Certain interests in net acreage may decrease after the Company has recovered the cost of initial wells incurred by it or may increase after others have incurred the cost of initial wells incurred by them.

(2) Certain of the net acreage in Canada is subject to agreements which require the Company to offer its drilling programs an opportunity to participate in the drilling of any wells on, and to acquire a working interest in, prospects delineated as part of prescribed areas of mutual interest. See "Drilling Programs".

(3) During fiscal 1980 the Company paid rentals of $392,090 to maintain its undeveloped acreage.

DRILLING PROGRAMS

The Company conducts a majority of its exploration and development activities through certain arrangements with drilling programs, primarily joint ventures with publicly and privately held limited partnerships and corporations. Aurora Energy Fund Ltd. ("Aurora Ltd.") or its wholly-owned subsidiary Aurora Energy Fund, Inc. ("Aurora, Inc.") (collectively, "Aurora") is the general partner and manages the business and affairs of ten such drilling programs. Officers and directors of the Company, including Robert W. Lamond, the Chairman of the Board and a Director of the Company, own a majority of the capital stock of Aurora Ltd. Copetrex Oil & Gas Co. Ltd. ("Copetrex"), an independent funding source, is the general partner of ten limited partnerships which have entered into joint ventures with the Company.

The Company has entered into arrangements, as operator, with the following drilling programs:

(i) **Canadian Aurora Programs.** The Company is a participant in joint ventures with six limited partnerships (the "Canadian Aurora Programs") of which Aurora Ltd. is the general partner. The Canadian Aurora Programs have engaged in drilling and production of oil and gas in Canada through joint ventures with the Company since 1977. Net proceeds from the sale of limited partnership interests in the Canadian Aurora Programs have totalled $59.9 million, of which $31.2 million was raised in 1980.

Under all the Canadian Aurora Programs, as compensation for the generation, acquisition, exploration, development and operation of the prospects, the Company receives a carried interest equal to 25% of the limited partnerships' interest in all prospects subject to the Company being required to pay at least 8.75% of the costs incurred by three of the limited partnerships or, in the case of Aurora-Czar 80-81 Energy Program, 16% of the costs incurred by the joint venture. All of the Canadian Aurora Agreements provide that the Company must bear its proportionate share of production facility costs.

Beginning in 1981 in respect of Aurora 78-79 Energy Program, Aurora-Czar 79-80 Energy Program and Aurora-Venus 79-80 Energy Program and 1982 in respect of Aurora-Czar 80-81 Energy Program, the Company may be required to purchase interests in oil and gas properties to enable the limited partnerships to finance the retirement of up to a maximum of 10% annually of the limited partnership interests initially issued by the programs. Upon the formation of Aurora Czar Energy Company Ltd. referred to below, the obligation in respect of Aurora 78-79 Energy Program and Aurora-Czar 79-80 Energy Program will be extinguished.

(ii) **Proposed Reorganization of Certain Canadian Aurora Programs.** It is proposed to reorganize all the publicly held Canadian Aurora Programs, other than Aurora-Venus 79-80 Energy Program and other than Aurora-Czar 80-81 Energy Program which has only recently completed its exploration program and which cannot yet be fairly evaluated. A preliminary prospectus in respect of this reorganization and the proposed offering referred to below was filed in February, 1981 in each of the Provinces and Territories of Canada. The preliminary prospectus provides that, subject to the requisite approval of limited partners, the limited partners' interests in the reorganized programs are to be sold to a new company, Aurora Czar Energy Company Ltd. ("ACE"), in consideration for common shares of ACE. The preliminary prospectus provides that the offering will be for a maximum of $40 million and a minimum of $10 million of shares for sale to the Canadian public in 1981. Approximately 70% of the net proceeds, if any, of this offering will be used to finance exploration and development of oil and gas prospects under a joint venture agreement with the Company.

Under the proposed joint venture agreement with ACE, the Company will be required to offer ACE, for a period of at least 3 years, a percentage designated by the Company of substantially all prospect interests acquired by the Company in Canada until the net proceeds raised on the formation of ACE have been expended. Such percentage is required to be not less than 25% of the interest available to Czar in the prospects. Interests must be offered to ACE at the lower of the Company's acquisition costs (adjusted to reflect the carrying costs of the prospect interest and allocable staff and other geological and geophysical costs) or fair market value.

Under this proposed joint venture agreement, drilling activities on prospects derived from properties purchased by ACE from the Canadian Aurora Programs will continue to be subject to the same cost sharing and revenue sharing provisions as applied while they were owned by the Canadian Aurora Programs. With respect to new prospects (other than prospects within areas of mutual interest relating to the existing properties) the preliminary prospectus contemplates that the Company will receive 33% of the revenues from any such prospect and will be obliged to pay 14% of exploration and development costs and 33% of operating costs.

The precise terms of the offering including the percentages referred to above are subject to finalization.

(iii) **United States Aurora Programs.** Aurora, Inc. and Czar U.S. are the general partners of two limited partnerships which were organized in 1979 and 1980 to acquire prospects in the continental United States, primarily Texas, Louisiana and Montana and to explore for, develop and produce oil and gas therefrom. The United States Aurora Programs received net proceeds of $5,882,825 U.S. from offerings of limited partnership interests to United States investors.

Czar U.S. serves as operator of most prospects acquired by the United States Aurora Programs. Czar U.S. generally bears only those costs in connection with the drilling and completion of wells that must be capitalized for United States federal income tax purposes. In addition, in the United States Aurora Program organized in 1980, if the capitalized drilling costs exceed 35% of aggregate drilling costs incurred for any well, 65% of such excess capitalized drilling costs are borne by the limited partners. Czar U.S. is allocated 37% of the net revenues (after deduction of operating costs) of the 1979 United States Aurora Program before payout and 45% of such revenues after payout. The comparable percentages for the 1980 United States Aurora Program are 29% before 150% of payout is achieved and 49% after 150% of payout is achieved. It is not anticipated that Czar U.S. will offer these Programs interests in additional prospects.

On February 10, 1981 Czar U.S. and Aurora, Inc. filed a registration statement for a proposed public offering in the United States of up to $20 million U.S. of limited partnership interests in Czar-Aurora 1981-A Limited Partnership and Czar-Aurora 1981-B Limited Partnership. These offerings are expected to close in June and October, 1981, respectively. While the Company expects these offerings to be successful, there is no assurance that any funds will be raised.

(iv) **Europa.** Europa Petroleum, Inc. ("Europa") was organized in 1980 to acquire oil and gas prospects in the United States and to explore for, develop and produce oil and gas on these prospects through a joint venture with Czar U.S. The business and affairs of Europa are managed by Aurora, Inc. Europa concluded an offering of $20 million U.S. of common shares to investors outside the United States and Canada in December, 1980. The net proceeds of the offering, before expenses, were $18,600,000 U.S.

Under the joint venture agreement between Czar U.S. and Europa, Czar U.S. is required, until December 31, 1983, subject to Europa having available financing, to offer Europa an interest in all oil and gas prospects in the United States in which Czar U.S. participates, other than certain prospects in prescribed areas where Czar U.S. has conducted activities with other drilling programs. The interest offered to Europa must be at least 25% of the interest available to Czar U.S. and not more than a 50% working interest in the prospect. Interests must be offered to Europa at the lower of the acquisition cost (adjusted to reflect the carrying costs of the prospect interest and allocable staff and other geological and geophysical costs) or fair market value. Czar U.S. will receive 20% of all revenues resulting from the operations conducted pursuant to the joint venture agreement and will pay a share of operating costs proportional to its working interest in respect of each joint venture prospect. Europa pays all other costs.

(v) **Shackleton.** Shackleton Petroleum Corporation and its U.S. subsidiary (collectively, "Shackleton") and the Company entered into a joint venture in 1980 to acquire oil and gas prospects in Canada and the United States through to June, 1983 and to explore for, develop and produce oil and gas on these prospects. The business and affairs of Shackleton are managed by Aurora. Shackleton on August 13, 1980 completed an offering of shares, principally in Canada and the United Kingdom, from which Shackleton has received net proceeds of $9,975,000 which have been utilized on exploration and development activities pursuant to its joint venture with the Company in Canada and the United States.

Under the joint venture agreement with Shackleton, the Company is required until June, 1983, subject to Shackleton having available financing, to offer Shackleton an interest in substantially all new prospects in Canada and the United States in which the company participates. Shackleton must be offered 12.5% of the interest available to the Company in Canadian prospects and 20% of the interest available to Czar U.S. in U.S. prospects, respectively. Interests must be offered to Shackleton at the lower of the Company's acquisition cost (adjusted to reflect the carrying costs of the prospect interest and allocable staff and other geological and geophysical costs) or fair market value. The Company will receive 20% of all revenue resulting from the joint venture and will pay a share of operating costs proportional to its working interest in respect of each joint venture prospect. Shackleton pays all other costs.

(vi) **Copetrex.** The Company has entered into joint ventures with ten limited partnerships of which the general partner is Copetrex Oil & Gas Co. Ltd. ("Copetrex"). Eight of these joint ventures were organized to explore in Canada and two in the United States (collectively, the "Copetrex Programs"). The limited partners of the Copetrex Programs are West German investors. The Copetrex Programs, which contributed a total of $40.3 million to joint ventures with the Company, drilled for gas and oil in Canada between 1974 and 1979 and in the United States in 1978 and 1979. The Company does not expect the Copetrex Programs to participate in the Company's exploration and development program in 1981 to any material extent.

Under its agreements with the Copetrex Programs, the Company has sold these Programs various working interests in oil and gas prospects. The purchase price for these interests has been payable, in part, on the date of acceptance of the prospects by Copetrex, with the balance together with interest thereon payable over a 26-year period. The Company has agreed to temporarily postpone certain of these payments because the interests to which they relate consist principally of interests in shut-in gas wells, gas production from which is not presently marketable. The outstanding balance of the purchase price is payable in fixed annual installments as to 5% for the first twelve years, 4% for the next five years, 3% for the next four years, 2% for the next three years and 1% for the remaining two years. Interest on the outstanding balance of the purchase price is payable in each year in an amount equivalent to a prescribed percentage of "net revenue" less any installment payment on the purchase price in that year. Because both the principal and interest received by the Company is derived from production revenue, the Company records the sale to Copetrex of its working interest in the properties as revenue in the earnings statement as and when the revenue is received. "Net revenue" for these purposes means the gross revenue less deduction of applicable royalties, direct taxes and operating costs. It is these net revenue interests which are referred to under "Reserves" and which are included in the reserve calculations. In addition to these payments relating to the purchase price of the interests sold to the Copetrex Programs, the Company has a direct interest in the net revenue from all wells on any prospect acquired from the Company by the Copetrex Programs in Canada.

By agreement dated May 11, 1979, Copetrex determined that it no longer wishes its limited partnerships to participate in new prospects in the United States. By agreement dated May 11, 1979, Copetrex has also confirmed to the Company that, until Copetrex advises the Company otherwise, the Company is no longer obligated to continue to offer participation in prospects outside areas of mutual interest.

DETAILS OF THE OFFERING

The Company offers pursuant to this prospectus 1,800,000 Units at a price of $13.00 per Unit, each Unit consisting of one Common Share and one-third of a Common Share Purchase Warrant.

The Common Shares of the Company are listed on the Toronto and Alberta Stock Exchanges. Application has been made to list the Common Shares on the Montreal Stock Exchange. Applications have also been made to list the Units on the Toronto, Montreal and Alberta Stock Exchanges until September 15, 1981 and thereafter to list the Common Share Purchase Warrants on such Exchanges separately from the Common Shares of the Company. Acceptance of each of the listings will be subject to the filing of required documents and evidence of satisfactory distribution, both within 90 days.

Description of the Common Shares

The Common Shares of the Company rank junior to the First Preference Shares of the Company both as to the return of capital and as to the payment of dividends and are entitled to one vote per Common Share. There are no First Preference Shares of the Company outstanding. All of the Common Shares outstanding are fully paid and non-assessable and the Common Shares offered hereby will, when issued, be fully paid and non-assessable.

Prior to the close of business on September 15, 1981, the Common Shares forming part of the Units offered hereby shall not be transferable separately from the related Warrants. See "Plan of Distribution".

Description of the Common Share Purchase Warrants

The Common Share Purchase Warrants (the "Warrants") entitling the registered holders thereof to purchase an aggregate of 600,000 Common Shares of the Company, as presently constituted, will be issued by the Company in accordance with the provisions of an indenture (the "Warrant Indenture") dated April 4, 1981 between the Company and The Canada Trust Company, as trustee.

One Warrant will entitle the holder to purchase one Common Share of the Company at any time after receipt and up to the close of business on September 30, 1982 at the price of $14.00 per share and thereafter and up to the close of business on April 30, 1986 at the price of $17.00 per share.

The Warrants will be transferable by delivery. Prior to the close of business on September 15, 1981, the Warrants are not transferable apart from the Units of which they form a part. See "Plan of Distribution".

The Warrant Indenture provides that the exercise price is subject to adjustment in certain events including:

(a) the subdivision, consolidation or reclassification of the Common Shares or the issue of Common Shares to all or substantially all the holders of Common Shares by way of a stock dividend, other than an issue of Common Shares to such holders as a dividend paid in the ordinary course (as such term is defined in the Warrant Indenture);

(b) the issue of rights, options or warrants to all or substantially all the holders of Common Shares entitling them within a period of 45 days to acquire Common Shares (or securities convertible into Common Shares) at less than 95% of the Current Market Price of the Common Shares; and

(c) the distribution to all or substantially all the holders of Common Shares of shares of any other class or of rights, options or warrants (other than those referred to above) or of evidences of indebtedness or of assets excluding dividends paid in the ordinary course (as such term is defined in the Warrant Indenture).

The term "Current Market Price" is defined in the Warrant Indenture to mean the weighted average price per share for the Common Shares for any 30 consecutive trading days (selected by the Company) commencing not more than 45 trading days before such date on The Toronto Stock Exchange, determined by dividing the aggregate sale price of all such shares sold on the said exchange during the said 30 consecutive trading days by the total number of such shares so sold.

No adjustment in the purchase price will be required to be made unless the cumulative effect of such adjustment or adjustments would change the purchase price by at least 1%.

The Company has covenanted in the Warrant Indenture that it will at all times reserve sufficient of its unissued Common Shares to satisfy the exercise of the Warrants.

The Company has also covenanted in the Warrant Indenture that, during the period in which the Warrants are exercisable, it will give public notice at least 21 days before taking certain actions specified in the Warrant Indenture.

Income Tax Considerations

There are certain federal Canadian income tax consequences to initial purchasers resident in Canada who hold the Common Shares and Warrants as capital property. Prospective purchasers are urged to consult their own tax advisers as to their particular income tax considerations.

Revenue Canada Interpretation Bulletin IT-96R3 provides that:

> "Where an option is issued with another security of the corporation but is severable from it and can be separately traded, the Department (of National Revenue, Taxation) considers that an allocation of the issue price plus any expenses of issue must be made between the option and the security. . . . However, this allocation need not apply where the option is not one of the main reasons for issuing the security and therefore is not of significant value."

On the basis that the Warrants are not one of the main reasons for issuing the Common Shares and therefore are not of significant value, the adjusted cost base of each Warrant would be nil. On this basis the amount of the gain to an initial purchaser of the Warrant would be the total proceeds of sale receivable by that purchaser. If an initial purchaser exercises Warrants and purchases Common Shares of the Company at the exercise price, the adjusted cost base of the Common Shares so acquired would be that exercise price. If an initial purchaser allows a Warrant to expire, there would be no federal Canadian income tax consequences.

CONSOLIDATED CAPITALIZATION

	Authorized or to be Authorized	Outstanding on October 31, 1980	Outstanding on January 31, 1981	Outstanding on January 31, 1981 after giving effect to this issue
Current Bank Debt				
Czar Resources Ltd.	(1)	$45,962,491	$48,986,190	—
Czar Resources Inc.	$17,482,500	$ 1,731,145	$ 4,591,117	$ 4,591,117
Long Term Debt (1)	$55,000,000	—	—	$27,369,190
First Preference Shares par value $25 each	600,000 shs.			
7½% Cumulative Redeemable Convertible First Preference Shares, Series A	320,000 shs.	—	—	—
Common Shares without nominal or par value (2)	15,000,000 shs.	9,613,553 shs.	9,613,553 shs.	11,413,553 shs.
		($36,228,940)	($36,228,940)	($57,845,940)

NOTES:

(1) On October 31, 1980 and January 31, 1981 the authorized current bank debt of the Company and Czar Resources Inc. were $50,000,000 and $4,819,960, respectively. The Company's bank line has been recently increased to $55 million constituting a 10 year term loan, repayable over 8 years commencing in 1983. The bank line of Czar Resources Inc. has also been recently increased to $17,482,500, one-half of which is available now and the remainder of which will be available upon the pledge of certain properties currently held by Czar Resources Inc. The Company has agreed, in connection with this line of credit, that it will not give a guarantee to, or enter into any agreement containing any negative covenants with, any other financial institution and that it will not encumber any of its assets or dispose of its resource properties (other than to its joint venture participants in the normal course of business) without, in each case, the bank's consent. The indebtedness of the Company under this line of credit is or is required to be secured by an assignment of accounts receivable and certain of the Company's petroleum and natural gas properties and its revenue interest therein, limited guarantees from certain Copetrex Programs and assignments of certain gas purchase contracts. All of the terms and conditions relating to the Canadian line of credit will be set forth in a loan agreement to be settled between the Company and the bank.

(2) As at October 31, 1980, 448,310 Common Shares were reserved pursuant to the terms of options granted to employees, officers and directors of the Company and one other person. As at April 3, 1981 there were 9,826,053 outstanding Common Shares. See Notes 3(b), (c) and (d) to the Consolidated Financial Statements.

(3) As at October 31, 1980 retained earnings were $4,565,083.

(4) See Note 5 to the Consolidated Financial Statements as to the extent of obligations arising by virtue of leases.

(5) 600,000 Common Shares will be reserved for issuance upon the exercise of the 600,000 Common Share Purchase Warrants to be outstanding after completion of this offering.

USE OF PROCEEDS

The estimated net proceeds to be received by the Company from the sale of the Units offered hereby will be approximately $21,617,000 after deducting the underwriting commission and estimated expenses relating to the issue aggregating approximately $1,783,000. These proceeds will be applied to reduce outstanding bank borrowings in Canada ($48,986,190 at January 31, 1981) incurred by the Company primarily to acquire interests in oil and gas prospects and to explore for, develop and produce oil and gas.

The Company has been granted a line of credit with its Canadian bank of $55 million and a $17.5 million line of credit with its United States bank. Repayment of a portion of the existing Canadian bank indebtedness from the net proceeds of this offering will result in the Company having funds available to it to assist in financing its ongoing operations. See "Exploration and Development Program".

DIVIDEND RECORD

During the fiscal year ended October 31, 1979 the Company paid dividends on the outstanding First Preference Shares, Series A at the stipulated annual rate of 7½% per annum and paid a dividend at such rate on all First Preference Shares, Series A which were redeemed on January 31, 1980. The Company has paid no dividends on its Common Shares. The Company does not intend to pay dividends on its Common Shares and future earnings will be retained to finance further exploration and development. Any decision to pay dividends on the Common Shares in the future will be made by the Board of Directors on the basis of the Company's earnings, financial requirements and other conditions at such time.

TRADING HISTORY OF THE COMMON SHARES

The table below sets forth, for the periods indicated, the reported volume of trading and the high and low sale prices of the Company's Common Shares on The Toronto Stock Exchange and the Alberta Stock Exchange, adjusted to reflect a 3-for-1 split effective September 1, 1978. Since the Common Shares were listed on The Toronto Stock Exchange substantially all trading in Common Shares has been on that Exchange and consequently the share volume on the Alberta Stock Exchange is not shown after June 30, 1978.

	High	Low	Share Volume
	$	$	
1978			
1st Quarter	6.50	4.58	637,830
2nd Quarter (T.S.E. from May 1)	8.38	6.33	863,580
3rd Quarter	8.38	6.75	714,800
4th Quarter	9.00	6.50	852,100
1979			
1st Quarter	9.00	6.75	864,300
2nd Quarter	10.50	7.50	1,203,700
3rd Quarter	16.25	8.63	2,880,700
4th Quarter	17.50	11.13	1,534,762
1980			
1st Quarter	21.88	13.25	3,190,531
2nd Quarter	18.75	13.88	1,635,029
3rd Quarter	19.13	14.25	1,461,446
October	18.50	14.75	912,228
November	18.75	15.50	784,830
December	18.88	15.88	328,509
1981			
January	17.50	15.00	258,706
February	15.50	13.00	243,611
March	13.50	12.00	312,114
April 1 to 3	13.50	12.75	81,301

The last sale of Common Shares on The Toronto Stock Exchange on April 3, 1981 was at $13.50.

PLAN OF DISTRIBUTION

Pursuant to an agreement (the "Underwriting Agreement") dated April 4, 1981 between Merrill Lynch, Royal Securities Limited, as Underwriter, and the Company, the Company has agreed to sell and the underwriter has agreed to purchase on April 24, 1981, or on such other date not later than April 30, 1981 as may be agreed upon, subject to the terms and conditions therein, the Units offered by this prospectus at a price of $13.00 per Unit, payable to the Company against delivery of certificates representing the Units. The Company has agreed to pay to the Underwriter, upon the successful completion of this offering, a fee for its services in advising the Company with respect to this offering of $1,458,000 (which fee is equivalent to a fee of 6.2% of the proceeds of this offering). The obligations of the Underwriter under the Underwriting Agree-

ment may be terminated at its discretion on the basis of its assessment of the state of the financial markets and may also be terminated upon the occurrence of certain stated events. The Underwriter is, however, obligated to take up and pay for all of the Units offered by this prospectus if any are purchased under the Underwriting Agreement.

In connection with this offering, the Underwriter may over-allot and effect transactions which stabilize or maintain the market price of the Common Shares or Units at a level above that which might otherwise prevail in the open market. Such transactions may be effected on the Toronto or Alberta Stock Exchanges. Such stabilizing, if commenced, may be discontinued at any time.

Certificates representing an aggregate of 1,800,000 Common Shares and 600,000 Common Share Purchase Warrants will be deposited with and held by The Canada Trust Company (the "Depositary") pursuant to an agreement to be made between the Company and the Depositary to be dated as of April 1, 1981 (the "Deposit Agreement"). Purchasers of Units will each receive registered Unit certificates representing the Common Shares and Warrants to which the registered holders thereof will be entitled as hereinafter provided. Each registered holder of such Unit certificate of record at the close of business on September 15, 1981 will be entitled to receive on and after September 15, 1981 from the Depositary definitive certificates representing the number of Common Shares and Warrants to which he is entitled in exchange for the Unit certificate registered in his name. On or before such date, the Common Shares and Warrants comprising such Units will not be transferable separately but only as Units and the transfer of such Units will constitute a transfer of the holder's interest in the underlying Shares and Warrants held by the Depositary. The Deposit Agreement will provide that the Depositary will provide proxies, when relevant, to the holders of Unit certificates in respect of Common Shares to which they are entitled in respect of any meeting of shareholders held at or before the date upon which Common Share certificates are available to the holders of Unit Certificates.

MANAGEMENT

Directors and Officers

The names of the directors and officers of the Company, the municipality of residence, the offices held by them in the Company and their principal occupations are as follows:

Name and Address	Office	Principal Occupation
Robert William Lamond* Calgary, Alberta	Chairman of the Board Director	Chairman of the Company
Ian Bell McMurtrie Calgary, Alberta	President Director	President of the Company
Leslie John Broker Houston, Texas	Vice-President Director	Vice-President of the Company
Christopher John Charles Bill* Toronto, Ontario	Director	Vice-President of Merrill Lynch, Royal Securities Limited
Bonita Olivia Rawlyck Calgary, Alberta	Treasurer	Treasurer of the Company
Trevor Llewellyn Clark Williams Calgary, Alberta	Land Manager	Land Manager of the Company
Allan Russell Twa Calgary, Alberta	Secretary	Lawyer with Burnet, Duckworth & Palmer

*Member of the Audit Committee

The Articles of Association of the Company allow for between 3 and 16 members on the Board of Directors until otherwise determined by a general meeting of shareholders. Accordingly, the Board of Directors may appoint directors, in addition to those elected at shareholders' meetings, up to a maximum number of 16 persons.

Mr. Bill has been a Vice-President of Merrill Lynch, Royal Securities Limited since February, 1974. During that period, Merrill Lynch, Royal Securities Limited has entered into two underwriting agreements with the Company as described under "Material Contracts" in addition to the proposed underwriting agreement described under "Plan of Distribution". Mr. Twa has been a lawyer with Burnet, Duckworth & Palmer since 1972. The particulars as to the background and experience of the other directors and of those officers and senior personnel of the Company responsible for its operations are as follows:

Certain Officers and Senior Personnel of Czar

Robert W. Lamond: Chairman of the Board and Chief Executive Officer, graduated from the University of Edinburgh in 1965 with an Honours degree in Geology. From 1965 to 1969 he held geological positions, first with Imperial Oil Ltd. and then with Mesa Petroleum Ltd. Mr. Lamond was employed by Skye Resources Ltd. from 1969 to 1974, where he held the position of Chief Geologist. Mr. Lamond is the founder of the Company and held the position of President of the Company from its incorporation in 1974 to September, 1980 when he was appointed Chairman of the Board.

Ian B. McMurtrie: President and Chief Operating Officer, graduated in 1970 from Queen's University, Kingston, Ontario with a Bachelor of Science (Honours) degree in Geology and was employed by Texaco Exploration Canada Ltd. from 1970 to 1976 where he was a senior geologist. In 1976 Mr. McMurtrie joined the Company as Chief Geologist and in 1977 he was appointed a Director of the Company and its Exploration Manager. Mr. McMurtrie was appointed Vice-President, Exploration in January, 1980 and President in September, 1980.

Bonita O. Rawlyck: Treasurer and Chief Financial Officer, graduated from the University of Alberta with a Bachelor of Arts degree in 1970. She was admitted to the Canadian Institute of Chartered Accountants in Ontario in 1973 after articling with Thorne Riddell, Chartered Accountants, and continued with Thorne Riddell until 1978. Mrs. Rawlyck joined the Company in 1978 as Controller and was appointed Treasurer in June, 1980.

Anthony D. Convey: Chief Engineer, graduated with a diploma in Petroleum Engineering Technology from the Southern Alberta Institute of Technology in Calgary in 1971. Mr. Convey had been employed for 7 years with respect to the supervision of drilling and completion operations with various companies in western Canada before he joined the Company in 1977 as Drilling Superintendent. In June, 1980 Mr. Convey was appointed Chief Engineer.

Sharon P. Runge: Controller, received the designation Registered Industrial Accountant in 1970 and has gained accounting experience in various oil and gas companies in Calgary since then. She was chief accountant for Siebens Oil and Gas Ltd. prior to joining the Company in 1979. Mrs. Runge was appointed Controller in June, 1980.

Robert H. Johnston: Chief Geologist, graduated from the University of Waterloo in 1974 with a Bachelor of Science in Geology (Honours) and was employed by Chevron Standard Limited in Calgary from 1974 to 1978 as a petroleum geologist. In 1978 he joined the Company as an exploration geologist and was appointed as Chief Geologist in November, 1980.

Trevor L. C. Williams: Land Manager, graduated in 1967 from the University of Calgary with a Bachelor of Arts Degree in Economics. He was employed by Texaco Canada Resources Ltd. in senior land department positions from 1967 to 1978, held the position of assistant to the Vice-President — Exploration from 1978 to 1979 when he became Manager — Project Planning at Texaco Canada Inc. Mr. Williams joined the Company in 1980.

Certain Officers and Senior Personnel of Czar U.S.

Leslie John Broker: Vice-President, graduated from Michigan Technological University in 1970 with a Bachelor of Science Degree in Geological Engineering. Mr. Broker has been employed as a geologist since 1970: from 1970 to 1973 in western Canada and from 1974 to 1977 with Tesoro Petroleum Corporation in the United States. In 1977 Mr. Broker joined Czar U.S. as Manager of Operations. In 1978 Mr. Broker was appointed a Director of Czar U.S. and in 1980 was appointed as Vice-President and a Director of the Company.

Phillip K. Swyden: Vice-President, Czar U.S. graduated from the University of Oklahoma with a Bachelor of Business Administration in Petroleum Land Management in 1972. He was employed by Continental Oil Company from 1972 to 1976 as a landman. In 1976 he joined Tesoro Petroleum Corporation as District Landman. In 1977 Mr. Swyden joined Czar U.S. as Chief Landman and in October, 1980 was appointed Vice-President of Czar U.S.

J. Michael Gatlin: Chief Engineer, graduated from Mississippi State University in 1969 with a Bachelor of Science Degree in Electrical Engineering. He was employed by Exxon Company U.S.A. as an engineer from 1969 to 1974. In 1974 Mr. Gatlin joined Tesoro Petroleum Corporation as a drilling engineer and in 1978 he joined First Energy Corporation as a petroleum engineer. In 1979 Mr. Gatlin joined Czar U.S. as Chief Engineer.

Peter R. Glidden: Division Geologist, graduated from Lamar University with a Bachelor of Science Degree in Geology in 1970 and graduated from Lehigh University with a Master of Science Degree in Geology in 1972. From 1972 to 1977 Mr. Glidden was employed by Exxon Company U.S.A. In 1977 Mr. Glidden joined Kirby Exploration Company as a geologist for the Gulf Coast Region. In 1979 Mr. Glidden joined Czar U.S. as Division Geologist.

Frederick R. Esch: Coordinator of Financial Planning, graduated from Southern Illinois University with a Bachelor of Science Degree in 1969 and graduated from Arizona State University with a Master's Degree in Business Administration in 1975. In 1976 Mr. Esch became a Certified Public Accountant. Mr. Esch was with the national public accounting firm of Main Hurdman & Cranstoun from 1975 to 1979 in their El Paso and Houston, Texas offices. Mr. Esch joined Czar U.S. in 1979.

Graham B. Livesey: Division Geologist and Manager, of the Denver, Colorado office graduated from University of Exeter, England with a degree of Geology (Honours). Mr. Livesey was employed as a wellsite geologist with Exploration Logging International Incorporated from 1971 to 1973, working in Angola, Gabon, Nigeria and Holland. From 1973 to 1974 he worked with Dresser Industries as a wellsite geologist and engineer in the Gulf Coast area of the United States. From 1974 to 1977 Mr. Livesey was employed as a petroleum geologist with Texaco Exploration Canada Ltd. Mr. Livesey was employed as a geologist in the Calgary office of Czar from 1977 to November, 1980 when he was transferred to the Denver, Colorado office.

Employment Agreement

Mr. Robert W. Lamond ("Lamond") has offered to enter into an employment agreement (the "Agreement") with the Company and the Company has accepted the offer. The Agreement will provide that Lamond will be employed by the Company as its Chief Executive Officer, holding office as Chairman of the Board for a term of two years commencing April 30, 1981.

Lamond is presently the controlling shareholder of a number of public companies and is a director of several of these companies. He also is a director of and principal shareholder of three private companies. See "Conflicts of Interest". Lamond will retain many of these directorships and shareholdings. However, subject to the foregoing and subject to his duties as a director of these companies, Lamond will agree that during the 2 year term of the Agreement he will not form or participate in the formation of, nor act as an officer of director of any other company or other entity.

Subject to the foregoing, throughout the 2 year term of the Agreement, Lamond will agree to devote his full time and attention to the affairs of the Company and not to be engaged in any business activity which will in any way interfere with the performance of his duties to the Company. Lamond will also agree that transactions between the Company and companies in which he has a material interest must either be on terms no less favourable to the Company than would be available in the industry generally and approved by a disinterested quorum of directors or must be approved by a majority of the votes cast, at a general meeting of shareholders, by disinterested shareholders. Reference is made to "Interest of Management and Others in Material Transactions".

Lamond agrees with the Company that, during the term of his employment by the Company at any time when the Company requires financing for its corporate purposes, Lamond will exercise his best efforts to ensure that the requisite financing is obtained for the Company and will exercise his best efforts to ensure that no financing which might otherwise reasonably be expected to be available to the Company for these purposes on terms commercially acceptable to the Company will be accepted by any entity controlled by Lamond unless, at such time, financing can reasonably be expected to be made available to the Company for such purposes, from the same or other sources, on terms commercially acceptable to the Company and in an amount sufficient to meet the requirements of the Company.

The Agreement will also provide, in effect, that Lamond will not sell or otherwise dispose of more than 10% of the Common Shares beneficially owned by him, directly or indirectly, during each of the 12 month periods ending April 30, 1982 and April 30, 1983, except to a purchaser who makes a bid to all shareholders to purchase their shares at the same price and on the same terms.

Remuneration of Directors and Senior Officers

Remuneration paid by the Company and its subsidiaries in fiscal 1980 to its directors and senior officers was as follows:

	Aggregate Remuneration	
Recipients	Salary and Bonus	Other (2)
	$	$
Directors (One)	—	4,000
Senior Officers (Five)	425,953	119,200

NOTES:

(1) The table states the amounts paid in fiscal 1980 separately for the listed categories of recipients in their respective capacities as senior officers or directors of the Company and its subsidiaries.

(2) The Aggregate Remuneration, Other column includes the spread between the exercise price and the fair market value of any shares purchased under employee stock options and, for senior officers, amounts contributed by the Company to deferred profit sharing plans. The remuneration paid to any of the persons included above does not include any additional value for personal use of Company owned or leased automobiles and club memberships. Although it is difficult to estimate the extent to which these facilities are used for personal purposes, the value thereof is estimated not to exceed $5,000 for any of the persons included above and not to exceed $22,000 for all such persons. See also "Employee Option and Other Plans".

Employee Option and Other Plans

The Company has granted options to purchase Common Shares to certain directors, senior officers and employees of the Company. The options are exercisable as to one-third each year from either the date of issue or from the first anniversary date of the date of issue on a cumulative basis and expire three or five years following the date of issue. Since October 31, 1980 options have been granted to purchase 20,100 Common Shares exercisable on or before February 26, 1986 at prices of $14.51 per share (18,000 shares) and $11.81 per share (2,100 shares). At the present time, there are options outstanding to subscribe for 255,910 Common Shares of the Company. If all such options were exercised, the aggregate consideration to be received by the Company would be $3,582,197. The closing price of the Common Shares on The Toronto Stock Exchange on April 3, 1981 was $13.50 per share. Particulars of all options which were outstanding on October 31, 1980 are set forth in note 3(c) to the Consolidated Financial Statements on page 52.

The various option exercise prices were approximately 10% below the market price on The Toronto Stock Exchange on the date the various options were granted. These optioned Common Shares have not yet been issued.

Since January 1, 1980 Common Shares were issued under various share option agreements to directors, senior officers or other employees of the Company and one other person as follows:

	Number of Shares	Price ($)
Directors and Senior Officers	144,900	4.17
	3,300	6.67
	8,000	6.75
	550	9.10
Other Employees	450	3.00
	1,500	6.67
	1,500	6.97
	10,000	7.31
Former Employees	37,110	4.17
	11,000	6.30
	4,000	6.75
	2,000	7.87
Other	72,000	5.70

An overriding royalty to a maximum of 2.5% of the Company's share of gross production, before deduction of Crown or freehold royalties, from wells spudded after March 30, 1980 has been reserved primarily for the benefit of certain of the professional staff of the Company who are employed at the time of spudding the prospect. The Company had its overriding royalty plan approved at the last annual general meeting of shareholders held March 28, 1980 and paid $4,141 to its senior officers during fiscal 1980. Mr. Lamond does not participate in the plan.

Principal Holders of Shares

The following are the only persons who, to the knowledge of the Company, own beneficially or of record, directly or indirectly, more than 10% of the issued Common Shares of the Company as at the date hereof:

Name and Address	Type of Ownership	Number of Shares	% of Class
216778 Alberta Ltd. #508 505 3rd St. S.W. Calgary, Alberta	Beneficial and of Record Beneficial	1,075,100 143,600	12.4

Note:

The issued shares of 216778 Alberta Ltd., a private holding company, are beneficially owned by Robert W. Lamond. Mr. Lamond also beneficially owns of record, in his personal capacity, 135,600 Common Shares of the Company, being 1.4% of the issued Common Shares.

The directors and senior officers of the Company, as a group, beneficially own, directly or indirectly, 14.15% of the Common Shares of the Company (11.37% after giving effect to this offering and to the exercise of the Common Share Purchase Warrants) and after the exercise of options outstanding to such directors and senior officers will own, directly or indirectly, 15.58% of the Common Shares of the Company (12.56% after giving effect to this offering and to the exercise of the Common Share Purchase Warrants).

Interest of Management and Others in Material Transactions

The following are the only material transactions entered into by the Company during the last three years, or which are presently proposed, in which any of the directors or senior officers or any of their respective associates had or has a material interest.

1. In respect of Canadian activities, certain directors and officers of the Company are the holders of common shares of Aurora Ltd., or own interests as limited partners in limited partnerships for which Aurora Ltd. is the general partner, or own shares of corporations which are managed by Aurora Ltd. and which limited partnerships or corporations have entered into a joint venture with the Company for the exploration and development of its Canadian properties.

   (a) Robert W. Lamond, the Chairman of the Board and a Director of the Company, beneficially owns 68.01% of the issued common shares of Aurora Ltd. and is a Director of Aurora Ltd. Ian B. McMurtrie, the President and a Director of the Company, beneficially owns 4.45% of the issued common shares of Aurora Ltd. Each of the other directors and officers of the Company, except C. J. C. Bill, own shares of Aurora Ltd. In the aggregate, the directors and officers of the Company own 74.9% of the issued common shares of Aurora Ltd.

   (b) The directors and officers of the Company have contributed $544,050 to subscribe for limited partnership interests in the various Canadian Aurora limited partnerships. Of this investment and shareholding Robert W. Lamond has contributed $369,050 by way of subscriptions to the Canadian Aurora limited partnerships.

2. In respect of United States activities, Robert W. Lamond is a director of Aurora, Inc. and Rubicon Oil & Gas, Inc., a wholly-owned subsidiary of Rubicon Oil & Gas Ltd., a corporation wholly-owned by Mr. Lamond and members of his family. Rubicon Oil & Gas, Inc. has invested $150,000 U.S. to subscribe for limited partnership units in one United States Aurora Program.

3. Aurora is in the business of raising funds in Canada and the United States through the organization of limited partnerships and public corporations. The limited partnerships or corporations enter into joint venture agreements which provide for the expenditure of monies by the limited partnerships or corporations to earn an interest in prospects of the Company on a joint venture basis. In consideration for acting as general partner and providing management services to the limited partnerships, Aurora receives various interests in revenues generated from the prospects and is reimbursed for its expenses. In the case of Shackleton and Europa, Aurora also provides management services to them, is reimbursed for its out-of-pocket expenses and benefits from holding the gross overriding royalty interest and share options described below. The various interests of Aurora in respect of these partnerships and public corporations are as follows:

Aurora Energy Fund Ltd.	
Aurora 77 Energy Fund	— 5% GORR (1)
Aurora 78 Energy Program	— 5% GORR (1)
Aurora 78-79 Energy Program	— 5% Net Carried Interest (2)
Aurora-Czar 79-80 Energy Program	— 5% Net Carried Interest (2)
Aurora-Venus 79-80 Energy Program	— 5% Net Carried Interest (2)
Aurora-Czar 80-81 Energy Program	— 5/65 of Partnership Interest
Shackleton Petroleum Corporation	— 9.74% of issued shares (3)
Aurora Energy Fund, Inc.	
Czar-Aurora 1979-A, U.S. Ltd.	— (4)
Czar-Aurora 1980 Oil & Gas Drilling Program	— (5)
Europa Petroleum, Inc.	— 10% of issued shares (6)
Shackleton Petroleum Corporation	— (3)

NOTES:

(1) The interest of these limited partnerships in the oil and gas assets acquired pursuant to the joint venture agreement with the Company is subject to a 5% Gross Overriding Royalty.
(2) Aurora Ltd. has earned a 5% net carried interest in the interest of these limited partnerships in their oil and gas assets acquired pursuant to the joint venture agreement with Czar. This interest will increase to 10% after payout.
(3) Aurora Ltd. has an option to purchase additional shares from the treasury of Shackleton exercisable on or before June 30, 1982 which will, if exercised, increase its percentage interest to 19.61%. In addition, Aurora Ltd. will earn a 5% gross overriding royalty in respect of wells drilled from the proceeds of future financing.
(4) Aurora, Inc. pays 1% of all costs and is entitled to a 3% working interest before payout and a 5% working interest after payout.
(5) Aurora, Inc. pays 1% of all costs and is entitled to 1% of revenues. Aurora also earns a 4% net profits interest proportionately reduced by and charged exclusively to the limited partners' account.
(6) Aurora, Inc. will earn a 5% Gross Overriding Royalty in respect of wells drilled from the proceeds of future financing.

At the annual shareholders' meeting of the Company held March 31, 1978, the shareholders approved the Company having entered into the joint venture agreements with Aurora 77 Energy Fund and Aurora 78 Energy Program and approved any further agreements for the raising of financing from time to time between Aurora and the Company on the basis that such financing be on terms not less favourable to the Company than those normally obtainable in the industry. Subsequently four other Aurora joint venture agreements were entered into on terms which, in the opinion of management, were not less favourable to the Company than those normally obtainable in the industry. The Company and Czar U.S. have entered into joint venture agreements with Shackleton, and Czar U.S. has entered into a joint venture agreement with Europa. Mr. Lamond is a director of Shackleton and Europa and, through Aurora, effectively controls each of these companies. The Company's subsidiary, Czar U.S. has entered into two limited partnership agreements dated June 11, 1979 and May 1, 1980 with Aurora Inc. as co-general partners and United States investors as limited partners. These agreements provide for Czar U.S. to earn an interest in the revenues of the limited partnership as co-general partner and, in the opinion of management, the sharing arrangements as between Czar U.S. and Aurora Inc. are not less favourable to Czar U.S. than those normally obtainable in the industry and represent fair compensation to Aurora Inc. for the services which it performs in connection with administering the affairs of those partnerships.

4. The preliminary prospectus referred to under "Proposed Reorganization of Certain Canadian Aurora Programs" provides that the Company will enter into a joint venture agreement with ACE which will acquire substantially all the oil and gas property interests held by four of the Canadian Aurora Programs and may raise a maximum of $40,000,000 from the public in Canada. Robert W. Lamond, Ian B. McMurtrie and C. J. C. Bill, directors of the Company, are to be directors of ACE. The joint venture agreement will deal with operations on properties tranferred from the four Canadian Aurora Programs and also with operations on properties acquired thereafter. With respect to properties acquired from the Canadian Aurora Programs the Company and Aurora will have the same interests as they had in the operation of those properties prior to their transfer to ACE. With respect to new prospects, it is presently proposed (subject to finalization) that the Company will have a 19% carried interest on all costs other than operating costs and Aurora will have a 3.5% carried interest on all costs other than operating costs.

5. Aurora 77 Energy Fund was formed on September 30, 1977. The Aurora 77 Energy Fund entered into a joint venture agreement dated September 1, 1977 with Czar pursuant to which certain Canadian properties of Czar were explored and developed. On November 30, 1979 Aurora 77 Energy Fund assigned to the Company its interest in certain oil and gas properties in the Birch area of British Columbia in consideration for $2,000,000, pursuant to a right of first refusal contained in the joint venture agreement. The Company had this agreement ratified at the special and annual general meeting held March 28, 1980. On January 1, 1980 Aurora 77 Energy Fund sold an interest in all of its assets to the Company for $793,472 in order to finance the retirement of units tendered by limited partners pursuant to an offer made by the limited partnership pursuant to the applicable limited partnership agreement.

6. The Company has entered into several drilling program agreements providing for the disposition and exploration of oil and gas prospects of the Company on a joint venture basis. Copetrex is the general partner of the limited partnerships formed pursuant to the laws of Alberta with which the

Company has entered into the drilling program agreements. Robert W. Lamond was a director of Copetrex from October 28, 1977 to June 29, 1978 during which time the Company entered into the drilling program agreement with Copetrex dated April 7, 1978. Mr. Lamond was nominated to the Copetrex board to satisfy the Alberta residency requirements for directors pursuant to The Companies Act (Alberta) and did not have and does not have any financial interest in Copetrex. Reference is made to "Drilling Programs — Copetrex".

Reference is made to "Drilling Programs" and to "Directors and Officers" for the municipality of residence of each of the individuals named above and to "Material Contracts" for information as to the availability of copies of such agreements.

Conflicts of Interest

Robert W. Lamond, as a principal shareholder, and Ian B. McMurtrie, as a shareholder, have various interests in a number of public and private companies carrying on business in the oil and gas industry, principally in western Canada. It is possible that, in the ordinary course of the business of Czar and in the ordinary course of the business of these other public and private companies, circumstances will arise where prospects may be offered to Czar and to one or more of these other companies by third parties. It is also possible from time to time that properties may be offered to Czar from one or more of those other oil and gas companies in which directors or officers of Czar have an interest. Thirdly, it is to be expected that properties acquired by Czar will be offered in whole or in part from time to time to one or more of the various drilling funds or other programs sponsored by Czar or may in fact be purchased by Czar from one or more of those funds or programs.

These various potential conflicts of interest will be dealt with in various ways. Transactions to be entered into by Czar in which directors or officers of Czar have a material interest must be approved in accordance with the provisions of Alberta law which, in effect, require the transaction in question to be approved either by a disinterested quorum of directors of Czar or by the approval of a majority of the votes cast at a general meeting of shareholders of Czar called for that purpose. In addition, Alberta law provides that the directors and officers of Czar have a fiduciary duty to and must act in the best interests of Czar. The Canadian Aurora Agreements contemplate that interests in prospects which are offered to the Aurora limited partnerships will be offered at the lower of cost or fair market value. Accordingly, under these agreements, Czar may be obliged to dispose of interests in properties below their fair market value where cost is less than fair market value. The various Aurora Agreements have been approved both retroactively and prospectively by the requisite majority of shareholders of Czar, all as required under Alberta law.

THE NATIONAL ENERGY PROGRAM

The federal government tabled on October 28, 1980 its proposed National Energy Program for Canada which, as amended by subsequent policy statements, included the following significant matters:

1. The federal government proposes an excise tax on all sales of natural gas and gas liquids. The tax, which is paid by the consumer, commenced November 1, 1980 on domestic sales and began February 1, 1981 on export sales. Such excise tax is initially 30¢ per Mcf of gas and will increase to 75¢ per Mcf of gas by January 1, 1983.

2. The federal government proposes a tax of 8% of net operating revenues relating to the production of oil, gas and natural gas liquids on the producer.

3. The federal government proposes to set the price for oil and gas in the inter-provincial and export market without agreement of the producing provinces. The current average wellhead price of Canadian conventional crude oil is set at $17.75 per barrel; increasing $1.00 per barrel semi-annually commencing on July 1, 1981 until the end of 1983. This price is substantially less than the current world price for oil.

4. Under the proposed National Energy Program the increases in the price of natural gas will be deferred by 13 months from the date of the corresponding oil price increases. The price of natural gas will also decrease relative to the price of oil.

5. The proposed National Energy Program includes a Petroleum Incentives Program pursuant to which certain grants will be payable to persons incurring exploration and development costs approximating those outlined in the Income Tax Act (Canada) for "Canadian exploration expenses" and "Canadian development expenses". For companies which have Canadian ownership of at least 75% and are Canadian controlled, grants are payable as to 35% of such Canadian exploration expenses and as to 20% of such Canadian development expenses. Lesser grants are available for companies that are Canadian controlled and that have Canadian ownership of between 50% and 75%. In 1981, the level of Canadian ownership required to obtain the maximum grants is 65%. This level increases by 2% each year until 1986 when the requisite level of 75%, referred to above, takes effect. It is unclear how a public corporation will ascertain its degree of Canadian ownership and control. See "Petroleum Incentives Program".

It is, of course, open to the federal government to amend all or any of these proposals. None of these proposals is yet law and no assurance can be given that they will become law in their present form. In response to these proposals, the province of Alberta recently passed regulations which will allow the reduction of deliveries of crude oil from Alberta Crown petroleum and natural gas leases in the amount of 60,000 barrels per day on each of March 1, 1981, June 1, 1981 and September 1, 1981. The first of these reductions went into effect as planned. Such reduction if fully implemented will reduce current Alberta crude oil production by 15%.

Position of the Company

The Company has analyzed the uncertainties to be encountered during 1981 in the oil and gas industry. The Company believes that the following factors are material in considering the impact which these uncertainties will have on the Company:

1. The Company has completed studies as to the present worth of its oil and gas revenues based on the proposals put forth in the proposed National Energy Program and has nevertheless established an increase in the present value of estimated future net revenue from its reserves as of October 31, 1980 of 41% from the present value thereof, discounted at 15%, as of October 31, 1979. See "Reserves".

2. The Company enjoys in excess of 31% of its present cash flow from production from oil and gas properties located in the United States. The Company established an office in the United States in 1977 and has increased its activities to the extent that during the 1981 fiscal year it expects to have 50% of its total exploration and development activities centered in the United States. This constitutes an increase from approximately 20% to 50% in activity in the United States from the 1980 fiscal year.

3. The Company has recently entered into an agreement with CGSL and Sherritt which contemplates the sale to CGSL for delivery to Sherritt of natural gas in order to supply the volumes of natural gas required by Sherritt for its planned ammonia manufacturing operation in Fort Saskatchewan, Alberta which is to be completed in 1983. The Company and certain of its joint venture participants are currently selling to CGSL 6.8 Mmcf of natural gas per day at a price which is approximately 70% of the average field price for natural gas plus 100% of the gas export rebate. As of February 1, 1983 the quantities of gas to be sold to Sherritt will increase to 28 Mmcf per day for the period February 1, 1983 to October 31, 1984 and to 30 Mmcf per day for the period from November 1, 1984 to October 1, 1995 at prices which constitute a higher percentage of the average field price for natural gas. See "Sale of Production".

4. The Company is presently Canadian controlled. The Company may have a Canadian ownership rating in excess of 65%. If so, and because the Company is Canadian controlled, the Company will

qualify in 1981 for the maximum grants available in respect of expenditures on provincial lands. See "Petroleum Incentives Program".

5. The decision by the Alberta government to cut back the export of oil by approximately 15% will not effect a significant decrease in the Company's revenues (about $100,000 in fiscal 1981 before income taxes).

RISK FACTORS AND INDUSTRY CONDITIONS

Risk Factors

Oil and gas exploration involves many risks which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that further commercial quantities of oil and gas will be discovered by the Company. The marketability of oil and gas acquired or discovered by the Company will be affected by numerous factors beyond the control of the Company. These factors include market fluctuations, the proximity and capacity of oil and gas pipelines and processing equipment and government regulation (including regulations relating to royalties, allowable production, importing and exporting of oil and gas and environmental protection). In addition, at the present time there is a surplus of producible natural gas reserves in Alberta and British Columbia as compared to current Canadian demand for natural gas. There is no assurance that the Canadian government will allow all or any part of this surplus to be exported to meet international demand. The exact effect of these factors cannot be accurately predicted but the combination of these factors may result in the Company not receiving any return on the Company's invested capital.

The oil and gas industry is intensely competitive in all phases. The Company, as an independent oil and gas exploration company, faces competition from other independent oil and gas exploration companies, individuals and major oil companies engaged in the acquisition, exploration, development and production of hydrocarbon substances in all areas in which the Company operates or proposes to operate. There is a high degree of competition for petroleum and natural gas lands which are favorably situated and prospectively desirable for exploratory operations. Many of the companies and individuals so engaged possess financial resources and technical facilities greater than those available to the Company and may therefore, among other things, be able to pay greater sums for desirable lands or to define more potentially productive prospects than the Company's financial or technical resources permit. There is also a high degree of competition for the relatively scarce services of the skilled personnel needed by the industry. The Company anticipates that competition may be expected to increase in view of the present worldwide demand for crude oil and natural gas.

The Company's oil and gas exploration operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering and oil spills, each of which could result in substantial damage to oil and gas wells, producing facilities, other property and the environment or in personal injury. Although the Company maintains liability insurance in an amount which it considers adequate, the nature of these risks is such that liabilities could exceed policy limits, in which event the Company could incur significant costs that could have a materially adverse effect upon its financial condition.

Another risk of the Company's operations is the necessity of incurring large expenditures for locating and acquiring properties, drilling exploratory wells and developing properties. In conducting its exploratory activities, the Company engages in programs which might be expected to provide substantial reserves in the event of a discovery but which may involve a relatively large investment and a high likelihood of failure. No assurance can be given that oil or gas will be discovered to replace reserves currently being developed, produced and sold, or that if oil or gas is found, it will be present in sufficient quantities to enable the Company to recover costs incurred in its discovery.

The ability of the Company to raise funds through the drilling programs is, to a large degree, the result of tax incentives provided by the relevant laws. There is no assurance that these incentives will not be changed adversely. Elimination of tax incentives would not detrimentally affect the value of the Company's

proven and probable reserves of oil and natural gas but would substantially curtail the speed with which the Company is able to expand. The Company's expansion would then be financed through bank borrowings, equity financing and such other financing methods as would then be appropriate.

A further risk of participation in the oil and gas industry in Canada relates to the degree to which the activities of the industry are regulated by the provincial governments and by the Canadian federal government. By virtue of the regulation of the industry by these levels of government it is uncertain whether, if oil and natural gas are located by the Company, the Company will be allowed to produce that oil and natural gas and, if the Company is allowed to do so, the price at which it is allowed to sell its product, whether domestically or on the export market, is subject to restraints under relevant government legislation. There is presently no assurance that the effect of such government restraints upon price, when combined with provincial and federal taxation, will allow the Company to realize a net profit after tax from the production of oil and natural gas.

As is common industry practice, little or no investigation of title is made at the time of acquisition of undeveloped properties, other than a preliminary review of local mineral records. Title investigations are made, in most cases by obtaining a title opinion of local counsel, before commencement of drilling operations. The Company believes that it generally has satisfactory title to its gas and oil properties. In Canada, such properties are subject to customary Crown interests, and all of its properties are generally subject to other royalty interests contracted in connection with the acquisition of the properties, liens incident to operating agreements, liens for current taxes and other burdens and minor encumbrances, easements and restrictions. The Company believes that none of such burdens materially detracts from the value of such properties or from the Company's interests therein or materially interferes with their use in the operation of the Company's business. Approximately 20% of the Company's properties are also pledged to secure bank borrowings.

Regulation

Canadian Regulation

The petroleum industry in Canada operates under federal, provincial and municipal legislation and regulations covering land tenure, royalties, production rates, pricing, environmental protection, exports and other matters. Under the British North America Act (1867) the federal government has jurisdiction over inter-provincial and international trade, whereas the provincial governments have jurisdiction over production of natural resources.

Recent conflicts between the federal government and various provincial governments with respect to jurisdiction over natural resources have created uncertainty as to future legislative conditions. Outlined below are some of the more significant aspects of governmental legislation and regulations which will affect the Company's operations.

Land Tenure

On December 9, 1980 the Canada Oil & Gas Act was given first reading in the House of Commons as Bill C-48. The Canada Oil & Gas Act, if enacted, will set forth new requirements for the holding, exploration and development of Canada lands (federal lands located in the Yukon and Northwest Territories and offshore Canada). The Canada Oil & Gas Act in part is designed to implement the federal government's proposed National Energy Program.

The majority of mineral rights in Alberta and British Columbia are owned by the Crown in right of the Province and a small percentage is held by freehold mineral owners. The governments of each of these provinces have enacted regulations respecting the rights of individuals, corporations and partnerships to explore for, drill and produce oil and natural gas on Crown lands.

All Alberta Crown petroleum and natural gas leases issued after July 1, 1976 have an initial term of five years, which term may be continued by production or deemed production in respect of all or part of the lands and formations included in such leases which are capable of commercial production. The rights to drill below the base of producing zones which are incapable of commercial production will revert to the province at the end of the primary term of the lease. The right to explore for petroleum and natural gas in the province

of Alberta may be acquired through exploratory licences or leases, for terms varying from two to five years, depending on the location of the land. Upon completion of certain drilling requirements, the holder of the licence is entitled to a lease of such lands. The holder of the lease is then permitted to produce from a well or wells drilled thereon under the terms and conditions of such lease.

Alberta Crown royalties on crude oil vary with the volume and price of monthly production of oil, up to 36% for new oil and up to 50% for old oil. The term "new oil" refers to oil obtained from certain exploratory wells licenced on or after April 1, 1974 and additional oil obtained as a result of enhanced recovery schemes approved on or after April 1, 1974. The royalty rate in Alberta for natural gas also varies with the monthly volume from the well and the selling price of natural gas sold in the province, such royalty rates varying up to 33% for new gas and up to 46% for old gas. The term "new gas" refers to natural gas discovered after January 1, 1974 or obtained from a pool not produced prior to January 1, 1974.

British Columbia Crown royalties on crude oil also vary with the volume of monthly production, and range from nil to approximately 30% for new oil and from nil to 40% for old oil. "New oil" is oil produced from a well drawing from a pool not containing a well completed prior to November 1, 1975 or from a pool not defined on November 1, 1975. In British Columbia, virtually all gas is purchased by the British Columbia Petroleum Corporation at a price substantially below the market value for natural gas, and such gas is exempt from Crown royalties.

Provincial Incentives

The province of Alberta has enacted Exploratory Drilling Incentive Regulations which provide for credits applicable to certain wells commenced prior to April 1, 1981. When a certified exploratory well on Crown lands, with the exception of most wells less than 2,000 feet in depth, results in an oil or gas discovery, no royalty is payable from the commencement date of the production for a period of five years in the case of oil and for a period of one year in the case of natural gas. In addition, credits may be earned through participation in eligible seismic and geophysical surveys pursuant to the Geophysical Incentive Program Regulations.

The Province of British Columbia has to date enacted no incentive programs.

Oil and Gas Pricing

Under the Petroleum Administration Act (Canada), the federal government can regulate the price of oil and gas in international and inter-provincial trade, either with or without provincial agreement. However, the pricing of oil and gas which is consumed outside of the province of its production has been determined from time to time by agreement between the federal government and the producing provinces. These pricing agreements established a two price system for oil and gas: the lesser price being the domestic price for oil and gas consumed in Canada, and the higher price being an export price for oil and gas exported from Canada. The most recent of these agreements with respect to the pricing of crude oil expired July 31, 1980, prior to which the federal government and the producing provinces had attempted unsuccessfully to reach a new agreement. The governments of Alberta and Saskatchewan acted unilaterally to increase the price of crude oil by $2.00 per barrel effective August 1, 1980.

The federal government under its proposed National Energy Program ("NEP"), proposes to set all future increases in the price of oil. The price of Canadian crude oil will be based on the weighted average cost of imported oil and various streams of domestic oil, referred to as the "blended price". This "blended price" will not be allowed to exceed 85% of the international price or the average price of oil in the United States, whichever is lower. The wellhead price of conventional oil increased $1.00 per barrel to $17.75 on January 1, 1981 and will rise a further $1.00 every 6 months until December 31, 1983. Thereafter, until December 31, 1985, the NEP proposes that the price increases will take place at the rate of $2.25 every 6 months. Commencing in 1986 the price will rise at the rate of $3.50 every 6 months until it reaches its appropriate quality-determined level relative to the oil sands. If by 1990 the conventional oil price is still below a "reference price", consideration will be given to a more rapid rate of escalation. The "reference price" will be the lesser of $38.00 per barrel, effective January 1, 1981 and escalated annually thereafter by the Consumer Price Index, and the international price.

Significant amounts of Alberta and Saskatchewan heavy crude oil are exported to the United States. Although the export price of such oil is substantially greater than the domestic price, the wellhead price received by the producer for exported oil is identical to that received for domestic oil. The difference consists largely of the export tariff which flows directly to the federal government. Under the NEP, the federal government proposes that as of November 1, 1980, 50% of the export tariff revenue be shared with the provinces of Alberta and Saskatchewan.

Prior to November 1, 1980, the price for natural gas established under the Petroleum Administration Act (Canada), known as the Toronto City Gate Price, was fixed at approximately 85% of the cost of oil in the Toronto area on an energy equivalent value. Through the various federal-provincial pricing agreements, the latest of which was extended to October 31, 1980, domestic gas prices have been increased in several stages to the current price of approximately \$2.60 per Mcf at the Toronto City Gate. In determining the average field price to the Alberta producer, one must subtract the cost of transportation to Toronto and the Alberta cost of service.

Under the NEP, the federal government, as of November 1, 1980, established common city-gate prices for natural gas shipped inter-provincially in all centres east of Alberta. The price of natural gas will, except during the calendar year of 1981, continue to rise \$0.15 per Mcf for every \$1.00 increase in the wellhead price of conventional crude oil. Within British Columbia and Alberta, the price of gas produced and consumed within the province will continue to be set by their respective provincial governments.

Approximately one-third of Alberta's natural gas production is currently exported to the United States. The price of natural gas exported to the United States as of April 1, 1981 is \$4.94 U.S. per Mcf, which price was set by the National Energy Board. The additional revenues generated from the excess of the export price over the domestic price are paid into Alberta's Natural Gas Pricing Agreement Act Fund, from which these revenues are then distributed as a price adjustment to all gas producers pro-rata according to their individual shares of Alberta production. As of March 1, 1981, the average sale price for gas removed from Alberta, including the price adjustment, was approximately \$2.54 per Mcf.

The price of natural gas in British Columbia is determined on a different basis from that in Alberta. The prevailing price is set by the British Columbia Petroleum Corporation, which is the purchaser of virtually all gas produced within British Columbia. Currently, producers of "new gas" are receiving approximately \$1.32 per Mcf and producers of "old gas" are receiving approximately \$1.12 per Mcf. Hearings to consider changes in the administration of gas pricing in British Columbia were held in 1980 and further hearings are anticipated for 1981.

All natural gas sales (including sales of liquified petroleum gas) in the domestic and export markets are, pursuant to the NEP, to be subject to a tax of \$0.30 per Mcf commencing November 1, 1980 which will increase by \$0.15 per Mcf on July 1, 1981, January 1, 1982, and January 1, 1983. This tax is added to the domestic price of natural gas and is therefore borne by the consumer. As a result of the Canada-United States agreements and gas export market conditions, the federal government has determined that the natural gas tax shall not be added to the export price of natural gas at this time. The impact of this tax on export of gas to the United States is uncertain at this time; any reductions in exports will likely reduce the monthly export adjustment currently received by Alberta producers.

Oil and Gas Production

The federal government, through the NEB, regulates the volumes of oil and gas exported from Canada. Because of a concern for Canada's energy self-sufficiency, the NEB instituted a policy in 1974 reducing permissible exports of light and medium gravity crude oil on a gradual basis with a view to phasing out such exports by the end of 1981. The present policy of the NEB is to permit exports of natural gas from Canada which are surplus to Canadian requirements as determined by the present protection formula of the NEB.

Generally, the provinces also have statutory provisions regulating the production of crude oil and natural gas. The regulations, among other things, require drilling permits, set well spacing, prevent the wasting of oil and gas resources, and control the rate of production. The provinces regulate the amount of oil and gas produced locally by assigning to each well or proration unit an allowable rate of production.

The production of crude oil from wells in western Canada is regulated by various agencies. Effective April 1, 1980 the Alberta Petroleum Marketing Commission became the exclusive marketer of all oil pro-

duced from Crown lands in the province. Under recently enacted amendments to The Mines and Minerals Act (Alberta), the Lieutenant Governor in Council may, if he considers it to be in the public interest to do so, make regulations fixing the maximum amount of petroleum that may be produced under Alberta Crown leases during any month. As a result of the Alberta and federal governments being unable to reach an agreement with respect to the price of crude oil, and the imposition by the federal government of the NEP without the agreement of the Alberta government, the government of Alberta has announced it will cut back oil production until an agreement is reached. The proposed cutbacks of production are to be 60,000 barrels per day as of March 1, June 1 and September 1, 1981, to a maximum of 180,000 barrels per day. The proposed reduction is subject to abatement in the event of a national emergency or a resolution of the dispute between the federal government and the province of Alberta as to the pricing of energy.

On December 6, 1979, the federal government announced that it would allow an increase in gas exports of up to 3.75 trillion cubic feet of natural gas over the next eight years. The NEB has recently approved an additional short-term export of 0.5 trillion cubic feet of natural gas. However, with respect to the consideration of future natural gas applications, the NEB has been asked by the federal government, pursuant to the proposals of the NEP, to take into account the level of Canadian ownership of the applicant, giving preference to Canadian owned and Canadian controlled firms. The NEB has indicated that it will consider applications for additional short-term exports which are designed to finance the pre-build portion of the proposed northern pipeline. Owing to the short-term nature of the newly authorized natural gas exports, the slow growth of the Canadian natural gas markets and the uncertainty of whether the purchasers of the natural gas authorized for export to the United States can obtain the necessary United States import approvals for such natural gas, there has been a general reluctance of the major exporters of natural gas to enter into long-term firm take-or-pay contracts with natural gas producers in Alberta. There is no assurance that future discoveries of natural gas in commercial quantities will be marketable.

Petroleum and Gas Revenue Tax

The NEP proposed a new Petroleum and Gas Revenue Tax. The Minister of Finance, Allan MacEachen, introduced draft legislation with respect to this new tax in the House of Commons on December 17, 1980 (the "draft legislation").

Part I of the draft legislation imposes an 8% tax commencing January 1, 1981 on the production revenue of every person. Production revenue is the net income from the production of petroleum or gas, or the processing in Canada of petroleum to any stage that is not beyond the stage of crude oil or its equivalent computed in accordance with the Income Tax Act (Canada) except that no deduction will be allowed for certain amounts including depletion, depreciation, exploration or development expenses, interest or other financial expenses, inventory and resource allowances, research expenses, and government royalties, taxes, lease rentals, or bonus payments with respect to the production of petroleum or gas.

Part II imposes a tax of 8% on resource royalties received by any person. A resource royalty is an amount computed by reference to the amount or value of production after December 31, 1980 of petroleum and gas. The person who pays a resource royalty is required to withhold the amount of this tax and remit that amount to the Receiver General for Canada.

The tax imposed by the draft legislation is not deductible in computing the income of a taxpayer under the Income Tax Act (Canada).

Petroleum Incentives Program

The NEP proposed that a new system of direct incentive payments be introduced and on December 19, 1980, the Department of Energy, Mines and Resources (Canada) released a document entitled "Petroleum Incentives Program — The Basic Rules — A Framework". This document proposes a method of determining the amount of incentive payments that will be made as a result of the proposed NEP. The level of incentive payments varies depending on the level of Canadian ownership and whether or not an applicant is Canadian controlled. On November 21, 1980 the Petroleum Monitoring Agency released a document entitled "Measurement and Determination for Canadian Ownership and Control". This document proposes a method of determining an applicant's Canadian ownership rate and whether or not the applicant is Canadian controlled. The Canadian ownership rate of a corporation is determined by reference to the beneficial ownership of the shares of that corporation.

A corporation that has a Canadian ownership rate of at least 65% in 1981 (increasing by 2% each year to 75% in 1986) and is Canadian controlled is entitled to incentive payments at the rate of: 80% of eligible exploration expenses incurred on Canada lands; 35% of eligible exploration expenses incurred on provincial lands; and 20% of eligible development expenses. These incentive payments will be made commencing in 1981. A corporation that has a lower Canadian ownership rate level is entitled to receive lesser incentive payments. In a case where these expenses are incurred on lands held by the applicant, the eligible expenses will be proportionately reduced if the costs borne by the applicant are in excess of its working interest in such lands. In a case where the applicant is incurring these expenses in order to earn a working interest, the eligible expenses will be proportionately reduced if the costs incurred by the applicant are more than double the working interest earned by the applicant in such lands. These are general rules and exceptions may be available in limited circumstances.

At the present time taxpayers are entitled to claim a depletion allowance which is generally equal to one-third of oil and gas exploration expenditures, development expenditures and certain capital expenditures. Individual taxpayers will no longer be eligible to earn depletion after 1980 but they will be able to deduct earned depletion after 1980, to the extent of their earned depletion base on December 31, 1980. The right of corporations to earn depletion for activities outside the Canada lands will be phased out. A corporate taxpayer's earned depletion base will include one-third of all eligible expenditures for 1982 and one-tenth for 1983. Thereafter, such expenditures will not earn depletion although a corporation will be able to deduct earned depletion to the extent of his earned base.

Natural Gas Bank

The NEP proposes to establish a gas bank for the purpose of purchasing natural gas from Canadian owned and Canadian controlled firms who are unable to find markets, and to enter into joint venture operations with such firms or to provide production loans to them.

Provincial Response to the NEP

As a result of the introduction by the federal government of the NEP, the Alberta government, in addition to its announcement of the cutbacks in production of conventional oil, has frozen approval of future oil sands and tertiary production projects. Further, the governments of the provinces of Alberta and British Columbia have announced their intention to challenge the natural gas excise tax imposed by the federal government under the provisions of the NEP. The controversies in federal-provincial relations created by the introduction of the NEP will, until their resolution, make it impossible to predict with any certainty the full impact of the NEP on the petroleum industry.

United States Regulation

General

The oil and gas industry in the United States is subject to extensive federal and state regulations governing both the conduct of operations and the marketing of hydrocarbons once production is established. Matters which are subject to federal or state control include permits to drill, the location of wells, measures required for protection of the environment, limitations on production for conservation, and enforced relationships between such producers of crude oil and their purchasers and between producers of certain natural gas sold in interstate and intrastate commerce for resale and their purchasers. Moreover, the Company's operations may be affected from time to time in varying degrees by changes in federal and state laws and regulations.

Numerous proposals have been and are being introduced in Congress which could materially affect the Company's oil and gas operations in the United States. The economics of oil and gas exploration and development are particularly sensitive to changes in tax laws and administrative regulations relating to the petroleum industry. In addition, oil and gas operations are subject to interruption or termination by governmental authorities on account of ecological and other considerations.

Oil Price Controls

Until January 28, 1981, crude oil production in the United States was subject to federal price and allocation controls. On that date, President Reagan signed an Executive Order removing those controls, effective immediately. Certain categories of production established under the system of price controls remain effective, but only for purposes of calculating the amount of Windfall Profit Tax due upon the sale of United States domestic crude oil.

Windfall Profit Tax

The Crude Oil Windfall Profit Tax Act of 1980 (the "Act") enacted an excise tax on the additional revenues from sales of oil production received as a result of oil price decontrol. The Act provides for the following:

(1) During the period 1980 - 1990 the tax is designed to raise $227.3 billion U.S. in revenues.

(2) Oil classified as "upper tier" (in general oil discovered and produced after May, 1973 but before June, 1979) and "lower tier" (which generally is oil discovered and produced before June, 1973) for price control purposes prior to decontrol is subject to tax as "tier 1 oil". The tax is 70% of the excess (less an adjustment for certain state severance taxes paid allocable to this excess) of (i) the removal price (generally the sales price) of the oil over (ii) a base price averaging approximately $14.17 U.S. per barrel on January 1, 1981, with grade, quality and locational differences. The base price is subject to adjustment for future inflation.

(3) Stripper oil (crude oil from wells which produced an average of 10 barrels or less during a 12 month qualifying period) is subject to tax as "tier 2 oil". The tax is 60% of the excess (less an adjustment for certain state severance taxes paid allocable to this excess) of (i) the removal price over (ii) a base price averaging approximately $16.60 U.S. per barrel on January 1, 1981 with grade, quality and locational differences. The base price is subject to adjustment for future inflation.

(4) Newly-discovered oil, incremental tertiary oil and heavy oil are subject to tax as "tier 3 oil". The tax is 30% of the excess (less an adjustment for certain state severance taxes paid allocable to this excess) of (i) the removal price over (ii) a base price averaging approximately $18.44 U.S. per barrel on January 1, 1981 with grade, quality and locational differences. The base price is subject to adjustment for future inflation, plus an additional ½% per quarter "kicker".

(5) The taxable "windfall profit" on a barrel of oil is limited to 90% of the net income attributable to that barrel of oil.

(6) Special treatment has been accorded to sales of certain categories of oil by "independent producers". Reduced tax rates apply to the first 1,000 barrels per day of an independent producer's combined production of oil subject to the tax on tier 1 oil and tier 2 oil. The reduced tax rate is 50% in the case of tier 1 oil and 30% in the case of tier 2 oil. Most royalty owners do not qualify for reduced tax benefits under the independent producer provisions.

(7) The Windfall Profit Tax paid is deductible from income for federal income tax purposes. However, the tax base for Windfall Profit Tax purposes is not required to be excluded from gross income for purposes of calculating percentage depletion. The deduction for the Windfall Profit Tax will have to be taken into account in computing the 50% of net income and 65% of taxable income limitations on the percentage depletion deductions.

(8) The Windfall Profit Tax is paid by each owner of an economic interest in the crude oil, including each partner; however, in most instances, the tax is withheld and deposited by the purchaser. If in any year the purchaser of crude oil from a particular property fails to withhold and deposit an amount equal to or greater than a partner's total Windfall Profit Tax liability for crude oil sold from the property during such year, such partner may be required to remit the difference together with an appropriate tax return filed on or before the last day of the first February following the close of such year.

It is anticipated that substantially all of the Company's future United States crude oil production will qualify for pricing and Windfall Profit Tax treatment as newly discovered oil or upper tier oil.

Gas Price Controls

The Natural Gas Policy Act of 1978 ("NGPA") came into force on November 9, 1978. The NGPA substantially altered the pre-existing system of federal price regulation over sales of natural gas. The NGPA establishes a comprehensive set of statutory ceiling prices applicable to all first sales of natural gas. This system provides differing ceiling prices for specific categories of natural gas production. Taken together these categories cover the entirety of domestic natural gas production. A significant departure of the NGPA from historical federal price regulation over sales of natural gas is that the ceiling prices established under the NGPA apply to sales of natural gas in intrastate commerce as well as to sales of natural gas in interstate commerce.

Administration and enforcement of the NGPA ceiling prices have been delegated to the Federal Energy Regulatory Commission ("FERC"), an independent commission established within the DOE. The manner in which the FERC implements and enforces the provisions of the NGPA may affect the extent to which the NGPA affects the operations of the Company.

New natural gas is defined by the NGPA to include natural gas produced from: (1) certain new leases on the Outer Continental Shelf; (2) certain new onshore wells; and (3) certain new onshore reservoirs.

The NGPA ceiling price for new natural gas was initially established as of April, 1977 at $1.75 U.S. per Mmbtu. This ceiling price for new natural gas increases monthly by an amount equal to the rate of inflation, as measured by the adjusted GNP implicit price deflator, plus a growth factor equal to 3.5% prior to May, 1981 and 4.0% thereafter.

New onshore production wells are defined as wells drilled on or after February 19, 1977, which satisfy applicable well-spacing requirements and are not drilled within an existing proration unit. The NGPA ceiling price for gas produced from a new onshore production well was initially established at $1.75 U.S. per Mmbtu as of April, 1977. This ceiling price increases monthly by an amount equal to the rate of inflation as measured by the adjusted GNP implicit price deflator.

Under the NGPA, unless a higher price is applicable, natural gas dedicated to interstate commerce prior to enactment of the NGPA is subject to price controls based upon the system of just and reasonable prices established by the FERC under the Natural Gas Act. However, more rapid price increases are provided under the NGPA than were provided under the Natural Gas Act.

The NGPA established ceiling prices for gas sold under existing intrastate contracts based upon the price terms of the contract in effect on the date of enactment of the NGPA. Contractually authorized price escalations may operate to increase the price under an existing intrastate contract up to the level of the new gas ceiling price (and, in some cases, higher).

Special prices are authorized under the NGPA for high cost gas and gas produced from stripper wells, i.e., wells which produce less than 60 Mcf per day during the ninety-day qualifying production period. The ceiling price for stripper well gas was established as $2.09 U.S. per Mmbtu as of May, 1978, with price increases authorized at the same rate as for new natural gas. Statutorily defined categories of high-cost gas including that produced from new wells completed at a depth of more than 15,000 feet is exempt from any federal ceiling price. The FERC has initiated administrative actions to establish incentive prices for other categories of high-cost gas, e.g., gas from tight formations.

The NGPA provides for removal of price controls over certain categories of natural gas production at certain specified dates. Thus, certain high-cost gas has been deregulated effective November 1, 1979. Additionally, three categories of natural gas production will be deregulated from NGPA ceiling prices on January 1, 1985:

(1) new natural gas;

(2) natural gas subject to an existing intrastate contract as of the date of enactment of the NGPA and for which the price on December 31, 1984 is higher than $1.00 U.S. per Mmbtu; and

(3) natural gas produced through a new onshore production well if the gas was not committed or dedicated to interstate commerce on or before April 20, 1977 and is produced from a completion location more than 5,000 feet deep.

Natural gas produced through a new onshore production well will be deregulated from NGPA ceiling prices on July 1, 1987, if the gas was not committed or dedicated to interstate commerce on or before April 20, 1977, and is produced from a completion location 5,000 or less feet deep. All other categories of natural gas production remain under NGPA ceiling price controls indefinitely. With respect to deregulation of categories of natural gas other than high-cost gas, the NGPA ceiling prices are subject to temporary reimposition for a single 18 month period. The President may temporarily reimpose controls at any time after June 30, 1985 and prior to July 1, 1987.

It is anticipated that most of the Company's future United States natural gas production will qualify for pricing treatment as new natural gas or as gas produced from new onshore production wells.

Environmental Regulations

The federal government and various state governments have adopted laws and regulations regarding the control of contamination of the environment. These laws and regulations may require the acquisition of a permit before drilling commences, prohibit drilling activities on certain lands lying within wilderness areas or where pollution arises and impose substantial liabilities for pollution resulting from drilling operations, particularly operations in offshore waters or on submerged lands.

Violation of environmental legislation and regulations may result in the imposition of fines and, in certain circumstances, the entry of an order for the abatement of the conditions, or suspension of the activities, giving rise to the violation.

Proposed Legislation

A number of bills were introduced during the last session of Congress which, if re-introduced during the present session of Congress and enacted, could have a significant impact upon the petroleum industry. The various bills and proposals involve, among other matters, the creation of a federal oil and gas company to compete with private industry and divestiture of various sectors of the energy industry from one another. It is not possible to predict what legislation, if any, may result from such bills and proposals and the effect their enactment might have upon the operations of the Company.

ELIGIBILITY FOR INVESTMENT

In the opinion of counsel, based on the five years ended April 30, 1980, the Common Shares of the Company will be, at the date of closing, investments:

(a) in which the Canadian and British Insurance Companies Act (Canada) states that a company registered under Part III thereof may invest its funds without resorting to section 63(4) of such Act;

(b) which the Foreign Insurance Companies Act (Canada) states are assets which may be vested in trust by a company registered under the said Act without resorting to section 4 of Schedule I of such Act;

(c) in which Schedule III to the Regulations made pursuant to the Pension Benefits Standards Act (Canada) states that a pension plan registered thereunder may invest its funds without resorting to the provisions of section 4 of said Schedule III;

(d) in which trust companies to which the Trust Companies Act (Canada) applies may invest their own funds without availing themselves of section 68(6) of such Act;

(e) in which The Pension Benefits Regulations, made pursuant to The Pension Benefits Act (Alberta), state that the funds of a pension plan registered thereunder may be invested without resorting to section 14(4) to such Regulations;

(f) which are qualified investments for a trust governed by a registered retirement savings plan or by a registered home ownership savings plan under the Income Tax Act (Canada);

(g) which an Act respecting insurance (Quebec) states than an insurer (as defined in section 1 thereof) incorporated under the laws of Quebec (other than a mutual association) may, without availing itself for that purpose of the provisions of section 256 thereof, acquire and hold; and

(h) which the Regulations made under the Supplemental Pension Plans Act (Quebec) state that a pension plan registered under that Act may acquire and hold without availing itself for that purpose of the provisions of section 6.17 of such Regulations, but subject to the limitations as to the amount set out in section 6.25 thereof.

At the date hereof, partners of and solicitors associated with Burnet, Duckworth & Palmer beneficially own, directly or indirectly, 500 Common Shares of the Company. On the same date, partners of and solicitors associated with Davies, Ward & Beck beneficially own, directly or indirectly, 1,725 Common Shares of the Company.

MATERIAL CONTRACTS

Except for contracts made in the ordinary course of business, the only material contracts entered into by the Company within the two years preceding the date hereof are the following:

1. Underwriting Agreement dated April 4, 1981 between the Company and Merrill Lynch, Royal Securities Limited. See "Plan of Distribution".
2. Warrant Indenture dated April 4, 1981 between the Company and The Canada Trust Company. See "Details of the Offering".
3. Letter dated March 31, 1981 in respect of an Employment Agreement to be made between Robert W. Lamond and the Company. See "Employment Agreement".
4. Joint Venture Agreement dated December 15, 1980 between Czar U.S., Europa Petroleum, Inc., and Aurora, Inc.
5. Joint Venture Agreement dated August 13, 1980 between the Company, Aurora Ltd. and Shackleton Petroleum Corporation and the Joint Venture Agreement dated August 13, 1980 between Czar U.S., Aurora, Inc., and Shackleton Petroleum, Inc.
6. Dedication Agreement dated July 31, 1980 between the Company, Consolidated Gathering Systems Limited and Sherritt Gordon Mines Limited.
7. Limited Partnership Agreement dated June 3, 1980 between Aurora Ltd., the Company and the Limited Partners of the Aurora-Czar 80-81 Energy Program and the Joint Venture Agreement dated June 3, 1980 between the Company and Aurora-Czar 80-81 Energy Program.
8. Agency Agreement dated April 18, 1980 between Merrill Lynch, Royal Securities Limited, the Company, Aurora Ltd. and The Canada Trust Company relating to Aurora-Czar 80-81 Energy Program. The commission payable to Merrill Lynch, Royal Securities Limited under this agreement was $1,969,800.
9. Limited Partnership Agreement dated May 1, 1980 between Aurora, Inc., Czar U.S. and the Limited Partners of the Czar-Aurora 1980 Oil and Gas Program.
10. Underwriting Agreement dated February 21, 1980 between the Company and Merrill Lynch, Royal Securities Limited in respect of the issuance of 1,500,000 Common Shares in 1980. The commission payable to Merrill Lynch, Royal Securities Limited under this agreement was $1,605,000.
11. Limited Partnership Agreement dated December 20, 1979 between the Company, Sun Life Assurance Company of Canada and Aurora Ltd. to form Aurora-Venus 79-80 Energy Program and Joint Venture Agreement dated December 20, 1979 between the Company and Aurora-Venus 79-80 Energy Program.
12. Petroleum Natural Gas and General Rights Conveyance dated November 30, 1979 between Aurora 77 Energy Fund, as assignor, and the Company, as assignee.
13. Limited Partnership Agreement dated July 26, 1979 between the Company, Aurora Ltd. and the Limited Partners to form Aurora-Czar 79-80 Energy Program and Joint Venture Agreement dated July 26, 1979 between the Company and Aurora-Czar 79-80 Energy Program.
14. Drilling Program Agreement dated July 2, 1979 between the Company and Copetrex Oil & Gas Ltd. Eighth Program.

15. Limited Partnership Agreement dated June 11, 1979 between Aurora, Inc. and Czar U.S., as co-general partners, and the Limited Partners to form Czar-Aurora 1979-A, U.S., Ltd.

16. Underwriting Agreement dated April 5, 1979 between the Company, Robert W. Lamond and Merrill Lynch, Royal Securities Limited in respect of the issuance of the First Preference Shares, Series A of the Company in 1979. The commission payable to Merrill Lynch, Royal Securities Limited under this agreement was $377,600.

Copies of the foregoing agreements and of the reserve reports of John Blain Engineering Ltd. and B. P. Huddleston & Co., Inc. referred to under "Reserves" and of Seaton-Jordan & Associates Ltd. and Kenneth W. Lane referred to under "Undeveloped Acreage" may be inspected at the office of the Company, 10th Floor, 333 - 5th Avenue S.W., Calgary, Alberta, during normal business hours during the period of distribution to the public of the Units offered hereby and for a period of thirty days thereafter and may also be inspected during normal business hours in the public files of the Ontario Securities Commission.

AUDITORS, TRANSFER AGENT AND REGISTRAR AND WARRANT INDENTURE TRUSTEE

The auditors of the Company are Thorne Riddell, Chartered Accountants, 12th Floor, Bow Valley Square Two, Calgary, Alberta.

The registrar and transfer agent for the Common Shares and the trustee under the Warrant Indenture is The Canada Trust Company at Halifax, Montreal, Toronto, Regina, Calgary and Vancouver.

DISCUSSION OF VARIATIONS IN OPERATING RESULTS

The significant factors influencing the yearly operating results of the Company, during the three fiscal periods ended October 31, 1978, 1979 and 1980 are discussed below.

1979 — 1980

The Company has continued to place more Canadian properties on stream and has increased production from United States properties. Production revenue has increased $3,728,685 or 125.3% from 1979. 37% of this revenue was derived from production in the United States. Principal and interest from property dispositions, which revenue is derived mainly from production from Canadian properties disposed of, has increased 11%. Production expense has increased 269.4% over 1979 due to increased production and to the increased use of compressors in Canada over what was required in 1979.

General and administrative expense has increased 161.6% over 1979. The main increase was in salary expense required due to the increase in personnel in the Calgary and Houston offices required to handle the increased drilling activity. The Houston office grew from 17 employees in 1979 to 50 in 1980. The increased activity also resulted in higher data processing fees, insurance expense, professional fees and general administrative costs. Transfer fees increased due to the higher level of share transfer activity resulting from the 1980 common share issue.

Other interest expense increased $1,734,667 or 402.9% over 1979 due to the use of the Company's operating lines of credit. These funds were used to finance the increased drilling activity and aggressive land acquisition policy which added $52.3 million to fixed assets during the year.

Depletion and depreciation increased by 200.4% due to the increased volume of production and the larger depletable base of assets. Part of this asset base is land acquired by Czar and held for itself and drilling fund participants. The acquisition cost of this land will be billed in part to these participants when wells are drilled on the lands.

As a result of these variations, although gross revenue increased by 88% from $4,722,186 in 1979 to $8,884,779 in 1980, net earnings decreased from $1,454,864 in 1979 to $1,034,573 in 1980. Earnings per share decreased from $.16 to $.10, or 37.5% due to a decrease in net earnings and an increase of 25% in the average number of shares outstanding. In January, 1980, 312,180 First Preference Shares, Series A were converted into 780,439 Common Shares and in March, 1980 the Company issued 1,500,000 Common Shares. Earnings per share were calculated after deducting from net earnings dividends paid on First Preference Shares, Series A of $149,947.

Current income tax recoveries in the last two years result from the Alberta Royalty Tax Credit and recovery of prior income taxes paid by Czar U.S.

1978-1979

Total revenue for 1979 increased 38% over 1978. The main increase was a 79% increase in production revenue which resulted from the Company being able to place more of its production on stream. Principal and interest from property dispositions increased correspondingly as this revenue is derived from an interest in oil and gas production. There was a 66% decline in management fees received pursuant to the Copetrex agreements as the agreement in effect throughout the greater part of the year through which new prospects were being acquired did not provide for a management fee. As funds from the Copetrex limited partnerships available for exploration declined, the Company increased its supply of funds from Canadian and United States limited partnerships.

Total expenses increased 129% over 1978 due to the increased production and drilling activity of the Company. Production expenses increased 106% as a result of increased production and start-up costs on new wells. Depreciation and depletion increased 158% as a result of increased production and an increase in the depletable base caused by the extensive drilling program during the year. This extensive drilling activity was financed partly by increased bank debt and this, together with increased interest rates during the latter part of the year, resulted in increased interest expense.

Basic earnings per Common Share decreased primarily because of the dividends paid on the First Preference Shares, Series A outstanding during the year, and the reduction in management fees.

1977-1978

Revenue increased in 1978 over 1977 by 65% due to an increase in production and in the management fees payable under the agreements with the Copetrex Programs. Expenses increased 77%, with interest expense a large contributor to the increase, due to the expenditure by the Company of more of its own funds in acquiring by purchase or farmins increased interests in prospects. These expenditures were financed by bank borrowings.

FISCAL 1981 TO DATE

Gross revenue from production and other sources for the first quarter of the 1981 fiscal year increased 169% over the same period in 1980, to $4,177,527 from $1,554,805. Cash flow increased 87% to $1,172,946 from $625,918. This cash flow increase is an increase from $.08 per share in 1980 to $.12 per share in 1981. Net earnings decreased from $203,788 to $153,206 due partly to higher depletion and depreciation charges which were based on a much higher depletable asset base, and increased interest expense. Earnings per share were $.01 per share, the same as the first quarter of 1980.

As at January 31, 1981 the consolidated working capital deficiency of the Company was $48,759,247. The Company estimates that its current consolidated working capital deficiency is approximately $60,000,000 after allowing for almost all of the expenditures associated with the winter drilling program. This working capital deficiency has been reduced by $55,000,000 by the conversion of the Company's Canadian bank debt to a term loan as described in note 1 to the capitalization table on page 25.

CZAR RESOURCES LTD.

CONSOLIDATED BALANCE SHEET

ASSETS

	October 31 1980	October 31 1979
Current Assets		
Accounts receivable — trade	$ 13,436,331	$ 6,252,672
— drilling programs	16,874,506	4,421,485
Inventory of supplies, at lower of cost and net realizable value	2,422,455	929,704
	32,733,292	11,603,861
Fixed Assets		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	79,976,114	27,629,456
Accumulated depletion and depreciation	3,485,091	1,226,608
	76,491,023	26,402,848
	$109,224,315	$38,006,709
LIABILITIES		
Current Liabilities		
Bank indebtedness (note 2)	$ 47,693,636	$ 7,233,073
Accounts payable and accrued liabilities	17,745,779	9,602,547
Drilling advances	814,127	299,600
Current portion of long-term debt	—	1,000,000
	66,253,542	18,135,220
Long-Term Debt	—	2,916,667
Deferred Income Taxes	2,176,750	2,260,029
SHAREHOLDERS' EQUITY		
Capital Stock (note 3)		
Authorized		
600,000 First Preference Shares with a par value of $25 each, issuable in series		
15,000,000 Common Shares without nominal or par value		
Issued		
7½% Cumulative Redeemable Convertible First Preference Shares, Series A	—	7,950,000
9,613,553 Common Shares	36,228,940	3,064,336
Retained Earnings (note 3)	4,565,083	3,680,457
	40,794,023	14,694,793
	$109,224,315	$38,006,709

Approved by the Board

(Signed) I. B. McMurtrie, Director

(Signed) Les J. Broker, Director

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended October 31				
	1980	1979	1978	1977	1976
Revenue					
Production	$6,703,575	$2,974,890	$1,658,230	$1,054,267	$201,658
Principal and interest from property dispositions	1,490,260	1,286,532	740,071	413,487	82,600
Management fees	361,105	342,298	1,002,790	605,018	189,830
Other	329,839	118,466	26,926	10,513	35,775
	8,884,779	4,722,186	3,428,017	2,083,285	509,863
Expenses					
Production	1,002,821	271,417	131,446	113,675	30,775
General and administrative	1,438,610	549,911	282,838	278,161	167,070
Interest on long-term debt	223,514	262,081	58,622	—	—
Other interest	2,165,252	430,585	225,733	11,543	375
Depletion and depreciation	2,302,395	766,326	296,602	160,397	21,908
	7,132,592	2,280,320	995,241	563,776	220,128
Earnings before income taxes	1,752,187	2,441,866	2,432,776	1,519,509	289,735
Income Taxes					
Current (recovery)	(55,587)	(129,526)	104,563	—	—
Deferred	773,201	1,116,528	795,058	524,120	99,100
	717,614	987,002	899,621	524,120	99,100
Net Earnings	$1,034,573	$1,454,864	$1,533,155	$ 995,389	$190,635
Earnings per Common Share, after deduction of dividends on First Preference Shares, Series A (note 4)	$.10	$.16	$.22	$.15	$.03

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	Year Ended October 31				
	1980	1979	1978	1977	1976
Balance at Beginning of Year	$3,680,457	$2,740,381	$1,207,226	$ 211,837	$ 21,202
Net earnings	1,034,573	1,454,864	1,533,155	995,389	190,635
	4,715,030	4,195,245	2,740,381	1,207,226	211,837
Dividends on First Preference Shares, Series A	149,947	219,072	—	—	—
Expenses of issue of First Preference Shares, Series A net of deferred income taxes of $290,400	—	295,716	—	—	—
	149,947	514,788	—	—	—
Balance at End of Year	$4,565,083	$3,680,457	$2,740,381	$1,207,226	$211,837

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended October 31				
	1980	1979	1978	1977	1976
Working capital derived from					
Operations					
Net earnings	$ 1,034,573	$ 1,454,864	$ 1,533,155	$ 995,389	$ 190,635
Items not requiring working capital	3,075,596	1,873,149	1,093,249	684,517	121,008
	4,110,169	3,328,013	2,626,404	1,679,906	311,643
Issue of long-term debt	—	1,541,667	1,375,000	—	—
Issue of Common Shares for cash and on conversion of advances from syndicates, net of share issue expenses	24,503,624	362,980	670,481	842,197	529,533
Issue of First Preference Shares, Series A for cash, net of share issue expenses	—	7,413,884	—	—	—
	28,613,793	12,646,544	4,671,885	2,522,103	841,176
Working capital applied to					
Additions to fixed assets	52,390,570	16,267,359	5,459,284	4,285,018	1,332,302
Reduction of long-term debt	2,916,667	—	—	—	—
Dividends on First Preference Shares, Series A	149,947	219,072	—	—	—
Redemption of First Preference Shares, Series A, for cash	145,500	—	—	—	—
	55,602,684	16,486,431	5,459,284	4,285,018	1,332,302
Decrease in working capital position	(26,988,891)	(3,839,887)	(787,399)	(1,762,915)	(491,126)
Working capital (deficiency) at beginning of year	(6,531,359)	(2,691,472)	(1,904,073)	(141,158)	349,968
Working capital (deficiency) at end of year	$(33,520,250)	$(6,531,359)	$(2,691,472)	$(1,904,073)	$ (141,158)

CZAR RESOURCES LTD.
Notes to Consolidated Financial Statements

(1) Accounting Policies

(a) *Principles of Consolidation*

The consolidated financial statements include the accounts of Czar Resources Ltd. and its wholly-owned subsidiaries, Czar Developments Ltd. and Czar Resources Inc.

(b) *Foreign Currency Translation*

The accounts of the foreign subsidiary are translated to Canadian dollars on the following basis:

(i) current assets and current liabilities at the rate of exchange in effect as at the balance sheet dates;

(ii) fixed assets at the rate of exchange in effect at the date on which the respective assets were acquired; and

(iii) revenue and expenses (excluding depreciation and depletion which are translated at the same rate as the related assets) at the average rate of exchange for the year.

(c) *Petroleum and Natural Gas Operations*

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized by cost center. A separate cost center is established for each country in which the Company operates, presently Canada and the United States. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells and related overhead expenditures. Such costs are depleted by cost center using the composite unit of production method based upon estimated proven developed reserves. In calculating depletion, natural gas reserves are converted to equivalent units of crude oil based on the relative net sales value of each product.

Under certain drilling programs, a significant portion of the consideration for the sale of properties by the Company to limited partnerships is payable to the Company by instalments over a period approximating 26 years. Principal and interest payments, in the aggregate, may not exceed a fixed percentage of net revenue from the wells drilled. Unpaid principal instalments total $52,376,456 at October 31, 1980 (1979 — $49,146,812). Such principal and interest payments will be recorded in the accounts of the Company as and when received.

All of the Company's exploration and development activities related to petroleum and natural gas are conducted with others; the accounts reflect only the Company's proportionate interest in such activities.

(d) *Depreciation*

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the composite unit of production method based on estimated proven developed reserves of each cost center. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

(2) Bank Indebtedness

Bank indebtedness is secured by an assignment of accounts receivable and certain petroleum and natural gas properties and revenue interests therein. The Company has agreed with its Canadian banker that it will not encumber any of its assets or dispose of any of its petroleum or natural gas properties, other than to its joint venture participants in the normal course of business, without, in each case, the consent of the bank.

(3) Capital Stock

(a) *First Preference Shares, Series A*

On March 30, 1979 the authorized share capital of the Company was increased to include 600,000 First Preference Shares with a par value of $25 each. Subsequently 320,000 shares were designated as 7½% Cumulative Redeemable Convertible Preference Shares, Series A (the "First Preference Shares, Series A") and were issued for an aggregate consideration of $8,000,000.

Changes in issued First Preference Shares, Series A were:

	Number of Shares	Consideration
Issued for cash in 1979	320,000	$8,000,000
Converted to Common Shares	(2,000)	(50,000)
Balance at October 31, 1979	318,000	7,950,000
Converted to Common Shares	(312,180)	(7,804,500)
Redeemed for cash	(5,820)	(145,500)
Balance at October 31, 1980	—	$ —

Retained earnings include a Capital Redemption Reserve Fund in the amount of $145,500 as required under the Alberta Companies Act in respect of the redemption of the 5,820 First Preference Shares, Series A, which fund is not available for the payment of dividends.

(b) *Common Shares*

On March 28, 1980 the authorized capital of the Company was increased from 10,000,000 to 15,000,000 Common Shares without nominal or par value.

Changes in the Company's issued Common Shares for the five years ended October 31, 1980 were:

	Number of Shares	Consideration
Balance at November 1, 1975	797,000	$ 609,145
Issued for cash less applicable share issue expenses of $68,717	245,000	519,283
Issued for cash on exercise of stock options	6,000	10,250
Balance at October 31, 1976	1,048,000	1,138,678
Issued on 2 for 1 stock split	1,048,000	—
Issued for cash less applicable share issue expenses of $47,553	168,000	821,697
Issued for cash on exercise of stock options	14,400	20,500
Balance at October 31, 1977	2,278,400	1,980,875
Issued on 3 for 1 stock split	4,556,800	—
Issued for cash less applicable share issue expenses of $14,579	150,000	547,921
Issued for cash on exercise of stock options	137,400	122,560
Balance at October 31, 1978	7,122,600	2,651,356
Issued for cash on exercise of stock options	96,870	362,980
Issued on conversion of First Preference Shares, Series A	5,000	50,000
Balance at October 31, 1979	7,224,470	3,064,336
Issued for cash less applicable share issue expenses of $1,070,301 (net of deferred income taxes of $856,480)	1,500,000	24,804,699
Issued for cash on exercise of stock options	108,644	555,575
Issued on conversion of First Preference Shares, Series A	780,439	7,804,330
Balance at October 31, 1980	9,613,553	$36,228,940

(c) At October 31, 1980 directors, officers and employees of the Company and Czar Resources Inc. and one other person held options to purchase 448,310 Common Shares of the Company as follows:

Date of Expiration	Exercise Price ($)	Number of Shares Optioned
Canada		
Directors and Senior Officers		
March 7, 1981	4.17	135,000
March 11, 1982	6.75	4,000
July 18, 1982	7.87	7,500
April 2, 1985	13.72	22,000
January 28, 1985	14.52	90,000
February 15, 1985	14.63	18,000
Employees		
May 17, 1982	6.97	3,000
July 6, 1982	7.31	3,500
July 18, 1982	7.87	1,000
May 13, 1985	13.28	2,100
September 21, 1985	13.39	2,400
September 28, 1985	13.61	5,100
April 2, 1985	13.72	6,000
May 23, 1985	13.95	15,300
May 24, 1985	14.17	2,400
April 15, 1985	14.18	3,000
February 14, 1983	14.63	3,000
February 15, 1985	14.63	2,100
June 22, 1985	15.41	3,000
October 6, 1985	15.53	1,500
March 13, 1985	15.75	1,000
July 20, 1985	16.31	1,500
July 14, 1985	16.43	2,400

Date of Expiration	Exercise Price ($)	Number of Shares Optioned
Other		
March 31, 1981	5.70	72,000
United States (Czar Resources Inc.)		
Directors and Senior Officers		
July 31, 1982	9.10	1,100
September 12, 1982	13.28	1,200
January 28, 1985	14.52	30,000
September 7, 1985	14.63	7,500
June 9, 1985	15.98	900
Employees		
January 22, 1983	13.90	360
June 9, 1985	15.98	450

(d) Subsequent to October 31, 1980, options were granted to senior officers and employees of Czar Resources Inc. to purchase 18,000 Common Shares at an exercise price of $14.51, expiring January 19, 1986. Options to subscribe for 7,500 Common Shares were granted to senior officers and options to subscribe for 10,500 Common Shares were granted to employees. Reference is made to note 8.

(4) Earnings Per Common Share

During April, 1977 the Company's Common Shares were split on a 2 for 1 basis and subsequently in September, 1978 the Common Shares were further split on a 3 for 1 basis. Retroactive cumulative effect of these stock splits on earnings per share data has been reflected in the accompanying financial statements.

Earnings per Common Share computations, after giving effect to the stock splits noted above, are based upon the weighted average number of shares outstanding during each year.

(5) Commitments and Contingent Liabilities

Lease commitments in respect of office premises and other equipment at October 31, 1980 aggregate approximately $6,340,000, and for each of the five years ending October 31, 1985 are: 1981 — $640,000; 1982 — $765,000; 1983 — $1,287,000; 1984 — $1,245,000; and 1985 — $996,000.

Commitments in respect of long-term drilling rig contracts at October 31, 1980 aggregate approximately $10,650,000 and for each of the two years ending October 31, 1982 are: 1981 — $9,144,000; and 1982 — $1,506,000.

Certain limited partnerships which have entered into joint ventures with the Company are required, beginning in 1981, to retire in each year up to a maximum of 10% of the limited partnerships' interests initially issued by the limited partnerships. The Company is required to purchase an interest in the assets of the limited partnerships to enable the limited partnerships to finance these obligations. The maximum obligation of the Company in 1981 in respect of such requirement is approximately $2,000,000.

(6) Segmented Information

The Company has a single line of business, which is the exploration for and the development and production of oil and gas. Information about the Company's operations by geographic segment for the year ended October 31, 1980 is as follows:

	Canada	United States	Total
Identifiable assets at October 31, 1980	$88,221,319	$21,002,996	$109,224,315
Production	$ 4,245,525	$ 2,458,050	$ 6,703,575
Principal and interest from property dispositions	1,429,654	60,606	1,490,260
	$ 5,675,179	$ 2,518,656	$ 8,193,835
Operating profit	$ 3,068,713	$ 1,819,906	$ 4,888,619
Other revenue			690,944
			5,579,563
General corporate expense			1,438,610
Interest expense			2,388,766
			3,827,376
Earnings before income taxes			$ 1,752,187

(7) Related Party Transactions

A significant shareholder, director and senior officer of the Company is a majority shareholder of a corporation which is the general partner of certain limited partnerships and the manager of certain other companies which have entered into joint ventures with the Company for the exploration and development of properties. At October 31, 1980 the said limited partnerships and companies were indebted to the Company in the aggregate amount of $13,833,365. This amount arose during the normal course of business and is included under Accounts receivable — drilling programs in the consolidated balance sheet of the Company as at October 31, 1980. In the year ended October 31, 1980 the charges made by the Company to such limited partnerships and companies totalled $31,730,352.

(8) Subsequent Events

(a) Reference is made to note 3.

(b) Pursuant to an Underwriting Agreement dated April 4, 1981 the Company has agreed to sell to an underwriter 1,800,000 Units of the Company consisting of 1,800,000 Common Shares and 600,000 Common Share Purchase Warrants for a cash consideration of $23,400,000.

(c) Subsequent to October 31, 1980, the Company's bank line of credit was increased to $55,000,000 constituting a ten year loan repayable over eight years to February 28, 1991 and the bank line of Czar Resources Inc. was increased to $17,482,500, one-half of which is available now and the remainder of which will be available upon the pledge of certain properties currently held by Czar Resources Inc.

AUDITORS' REPORT

To the Directors of
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. as at October 31, 1980 and 1979 and the consolidated statements of earnings, retained earnings and changes in financial position for each of the five years ended October 31, 1980. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at October 31, 1980 and 1979 and the results of its operations and the changes in its financial position for each of the five years ended October 31, 1980 in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Canada
February 13, 1981
(April 4, 1981
as to notes 8(b) and 8(c))

(Signed) THORNE RIDDELL
Chartered Accountants

PURCHASERS' STATUTORY RIGHTS

Sections 70, 126 and 135 of The Securities Act, 1978 (Ontario) provide, in effect, that when a security is offered in the course of a distribution or a distribution to the public:

(a) a purchaser will not be bound by a contract for the purchase of such security if written or telegraphic notice evidencing his intention not to be bound is received by the dealer from whom the purchaser purchased the security no later than midnight on the second business day after the latest prospectus and any amendment to the prospectus offering such security is received or deemed to be received by the purchaser or his agent, and

(b) if a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and, subject to the limitations set forth in such Act,

(1) the purchaser has a right of action for damages against,

(i) the issuer or a selling security holder on whose behalf the distribution is made,

(ii) each underwriter required to sign the certificate required by section 58 of such Act,

(iii) every director of the issuer at the time the prospectus or amendment was filed,

(iv) every person or company whose consent has been filed pursuant to a requirement of the regulations under such Act but only with respect to reports, opinions or statements made by them, and

(v) every other person or company who signed the prospectus or the amendment,

but no action to enforce the right can be commenced by a purchaser more than the earlier of 180 days after the purchaser first has knowledge of the facts giving rise to the cause of action or three years after the date of the transaction that gave rise to the cause of action, or

(2) where the purchaser purchased the security from a person or company referred to in (i) or (ii) above or from another underwriter of the securities, he may elect to exercise a right of rescission against such person, company or underwriter, in which case he shall have no right of action for damages against such person, company or underwriter, but no action to enforce this right can be commenced by a purchaser more than 180 days after the date of the transaction that gave rise to the cause of action.

Sections 64 and 65 of The Securities Act (Alberta), sections 71 and 72 of The Securities Act (Saskatchewan) and sections 63 and 64 of The Securities Act (Manitoba) provide, in effect, that when a security is offered in the course of a distribution to the public referred to in such Acts:

(a) a purchaser will not be bound by a contract for the purchase of such security if written or telegraphic notice evidencing his intention not to be bound is received by the vendor or his agent not later than midnight on the second business day after the prospectus or amended prospectus offering such security is received or is deemed to be received by the purchaser or his agent, and

(b) a purchaser has the right to rescind a contract for the purchase of such security, while still the owner thereof, if the prospectus or any amended prospectus offering such security contains an untrue statement of a material fact or omits to state a material fact necessary in order to make any statement therein not misleading in the light of the circumstances in which it was made, but no action to enforce this right can be commenced by a purchaser after the expiration of 90 days from the later of the date of such contract or the date on which such prospectus or amended prospectus is received or is deemed to be received by the purchaser or his agent.

Sections 60 and 61 of the Securities Act (British Columbia) provide, in effect, that when a security is offered to the public in the course of primary distribution:

(a) a purchaser has the right to rescind a contract for the purchase of such security, while still the owner thereof, if a copy of the last prospectus together with financial statements and reports and summaries of reports relating to the security, as filed with the Superintendent of Brokers of British

Columbia, were not delivered to him or his agent prior to delivery to either of them of the written confirmation of the sale of the security. Written notice of intention to commence an action for rescission of the contract to sell the security must be served on the person who contracted to sell the security within 60 days of the date of delivery of the written confirmation of the sale of the security, but no action to enforce this right can be commenced after the expiration of three months from the date of service of such notice, and

(b) a purchaser has the right to rescind a contract for the purchase of such security, while still the owner thereof, if the prospectus or any amended prospectus offering such security contains an untrue statement of a material fact or omits to state a material fact necessary in order to make any statement therein not misleading in the light of the circumstances in which it was made, but no action to enforce this right can be commenced by a purchaser after the expiration of 90 days from the date of such contract or the date on which such prospectus or amended prospectus is received or is deemed to be received by the purchaser or his agent, whichever is the later.

Reference is made to the aforesaid Acts for the complete texts of the provisions under which the foregoing rights are conferred. The foregoing summaries are subject to the express provisions thereof.

Dated: April 4, 1981

CERTIFICATE OF THE COMPANY

The foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part 7 of the Securities Act (British Columbia), Part 7 of The Securities Act (Alberta), Part VIII of The Securities Act (Saskatchewan), Part VII of The Securities Act (Manitoba), Part XIV of The Securities Act, 1978 (Ontario), the Securities Act (Quebec), section 13 of the Securities Act (New Brunswick), and by the respective regulations thereunder.

(Signed) I. B. McMurtrie
President

(Signed) B. Rawlyck
Chief Financial Officer

On behalf of the Board of Directors:

(Signed) Christopher Bill
Director

(Signed) Les J. Broker
Director

CERTIFICATE OF THE UNDERWRITER

To the best of our knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part 7 of the Securities Act (British Columbia), Part 7 of The Securities Act (Alberta), Part VIII of The Securities Act (Saskatchewan), Part VII of The Securities Act (Manitoba), Part XIV of The Securities Act, 1978 (Ontario), the Securities Act (Quebec), section 13 of the Securities Act (New Brunswick), and by the respective regulations thereunder.

MERRILL LYNCH, ROYAL SECURITIES LIMITED

By: (Signed) Christopher Bill

Merrill Lynch, Royal Securities Limited is, indirectly, a wholly-owned subsidiary of Merrill Lynch, Pierce, Fenner & Smith Inc.

Ronalds Western
PRINTED IN CANADA

Preliminary Prospectus dated February 13, 1981.

This prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence.

Securities Commissions and with the Superintendent of Brokers of British Columbia, but which has not yet become final for the purpose of a distribution to the public. Information contained herein is subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted in any such province prior to the time a receipt is obtained for the final prospectus from the appropriate Securities Commission or from such Superintendent, as the case may be.

New Issue:

CZAR RESOURCES LTD.

• Common Shares

(without nominal or par value)

Carrying the right to receive Common Share Purchase Warrants

Common Share Purchase Warrants

Holders of record of the Common Shares offered hereby at the close of business on • 1981 will receive one Common Share Purchase Warrant for each • Common Shares held. • Warrants will entitle the holder to purchase one Common Share at a price of $ • per share on or before • , 19• and thereafter at a price of $ • per share on or before • , 19•.

In the opinion of counsel, the Common Shares will be eligible for investment under certain statutes as set forth under "Eligibility for Investment" on page 40.

PRICE: $ • per Share

	Price to Public	Underwriting Commission	Proceeds to Company (1)
Per Share	$ •	$ •	$ •
Total	$ •	$ •	$ •

(1) Before deducting expenses of the issue estimated at $275,000.

The Common Shares of the Company are listed on the Alberta and Toronto Stock Exchanges.

We, as principals, conditionally offer these Common Shares carrying the right to receive Common Share Purchase Warrants, subject to prior sale, if, as and when issued by the Company and accepted by us in accordance with the conditions contained in the Underwriting Agreement referred to under "Plan of Distribution" on page 23.

Subscriptions will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. It is expected that definitive certificates for the Common Shares will be available for delivery on or about • , 1981.

SUMMARY

The Offering

The Issue: • Common Shares at $ • per share carrying the right to receive • Common Share Purchase Warrants. See "Details of the Offering" on page 21 and "Plan of Distribution" on page 23.

Warrants: Holders of record of the Common Shares offered hereby at the close of business on • , 1981 will receive one Common Share Purchase Warrant for each • Common Shares held. • Warrants will entitle the holder to purchase one Common Share at a price of $ • per share on or before • , 19• and thereafter at a price of $ • per share on or before • , 19•.

Use of Proceeds: The estimated net proceeds of $ • will be applied to reduce outstanding bank indebtedness in order to increase the cash flow available for the Company's continuing exploration and development program and to increase unused bank lines of credit. See "Use of Proceeds" on page 21 and "Exploration and Development Program" on page 15.

The Company

Business: The Company is in the business of exploring for, developing and producing petroleum and natural gas in western Canada and the United States. See "Business" on page 5.

Reserves: As at October 31, 1980, the Company's total reserves of oil and natural gas were, respectively, 67% and 21% higher than as at October 31, 1979.

The estimated future net revenues from the Company's reserves as at October 31, 1980 were as follows:

	Undiscounted	10%	Discounted at 15%	20%
Canada	$813,346,884	$234,014,007	$151,233,942	$106,356,856
United States	65,885,619	46,446,588	40,227,543	35,374,705
	$879,232,503	$280,460,595	$191,461,485	$141,731,561

Discounted at 15%, the estimated future net revenues have increased 41% since October 31, 1979. See "Reserves" on page 8.

Production and Financial Data:

	12 months ended October 31 1980	1979
Revenue after royalties	$ 8,884,779	$ 4,722,186
Capital expenditures	$52,390,570	$16,267,359
Working capital from operations	$ 4,110,169	$ 3,328,013
Net earnings	$ 1,034,573	$ 1,454,864

See "Production Information" on page 10 and the Consolidated Financial Statements of the Company commencing on page 43.

Undeveloped Acreage: As at December 31, 1980 and October 31, 1980 the estimated replacement cost of the undeveloped land holdings (312,916 net acres and 972,906 gross acres in total) in Canada and the United States was $50,926,948 and $3,725,496, respectively. See "Undeveloped Acreage" on page 13.

Risk Factors: The petroleum industry is subject to a number of exploration, production and regulatory risks. See "Risk Factors and Industry Conditions" on page 31. The Company's position in the face of the proposed National Energy Program is set forth on page 30.

mation contained elsewhere in this prospectus.

Recent and Proposed Activities of the Company

Canadian Activities

During fiscal 1980 the Company expended $38.7 million on its own behalf on exploration and development in Canada. The Company participated in the drilling of 135 wells located in northeast British Columbia and in central and southern Alberta.

Over the next two years the Company will concentrate its exploration and development activities on prospects likely to generate an early cash flow to the Company and to a lesser extent on areas where cash flow may be delayed but where reserve discoveries may be made at relatively low cost. Accordingly, drilling will be concentrated in southern Alberta in areas such as at Parkland-Claresholm and Hussar where the Company has gas sales contracts and in the Petitot and Monias-Callisto-Boudreau areas of British Columbia.

Should financing be available, the Company anticipates spending up to $75 million in Canada over the next two years on its own behalf and on behalf of drilling programs and may drill up to 200 wells.

The Company recently entered into an agreement to supply natural gas for Sherritt Gordon Mines Limited's planned ammonia manufacturing operation in Fort Saskatchewan, Alberta. This contract will allow the Company to sell up to 37 Mmcf per day by February, 1983 of its available natural gas in Alberta at prices which represent discounts from the average field price for natural gas. See "Sale of Production" on page 11.

United States Activities

As at October 31, 1979 the Company's U.S. oil and gas reserves accounted for approximately 1% of its total reserves. During fiscal 1980 the Company spent $13.2 million U.S. on its own behalf and $4.6 million U.S. on behalf of drilling programs and drilled 35 wells in the United States, with a success rate of 71%. By October 31, 1980 the Company had U.S. oil and gas reserves with estimated future net revenues therefrom, discounted at 15%, of more than $40 million. At this date, U.S. reserves accounted for 48% of the Company's estimated proved crude oil reserves and 2% of the Company's estimated proved natural gas reserves. See "Reserves" on page 8.

Czar anticipates spending up to $45 million U.S. in the United States in fiscal 1981 on its own behalf and on behalf of drilling programs. The Company will continue its exploration in the Austin Chalk trend in Texas where the Company has an interest in approximately 30,000 gross acres (10,000 net acres), has acted as operator in drilling and completing 10 producing oil wells, and where cash flow to the Company in January, 1981 amounted to $500,000 U.S. after royalties, Windfall Profit Tax and operating expense.

Other areas of activity in the United States in fiscal 1981 will include the Anadarko Basin of Oklahoma, the San Juan Basin of New Mexico and prospects in Montana.

Financing

During fiscal 1980, approximately $70 million was made available through various drilling programs for the Company's exploration and development activities in Canada and the United States of which a substantial portion was spent after fiscal 1980 and approximately $25 million remains to be spent during fiscal 1981.

The Company anticipates obtaining up to $100 million from drilling program investors in fiscal 1981. If $100 million is obtained, the Company estimates that its financial commitments in 1981 and early 1982 will total approximately $20 million which would be financed in part by the Company's increasing cash flow and its unused bank lines of credit.

Ownership

The Company is Canadian controlled and believes that under the terms of the proposed National Energy Program it has a Canadian ownership rating in excess of 65% and may after this issue have a Canadian ownership rating of more than 75%. As a result the Company will be entitled to grants commencing in 1982 and may be entitled to grants in 1981. See "Petroleum Incentives Program" on page 36.

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Unless otherwise stipulated all amounts calculated in United States dollars have been translated into Canadian dollars on the basis that U.S. $1.00 = Cdn. $1.1655.

THE COMPANY

General

Czar Resources Ltd. was incorporated as a private company by Memorandum of Association under the laws of the Province of Alberta on April 11, 1974 and converted to a public company on July 5, 1975. The Company has two wholly-owned subsidiaries, Czar Developments Ltd. (an Alberta corporation) which operates in Canada, and Czar Resources Inc. ("Czar U.S.") (a Delaware corporation) which operates in the United States. In this prospectus, unless the context otherwise indicates, the "Company" and "Czar" refer to Czar Resources Ltd. and its subsidiaries.

The head office of the Company is located at 333 - 5th Avenue S.W. (10th floor), Calgary, Alberta T2P 3B6 and the head office in the United States is located at 333 North Belt, Suite 400, Houston, Texas 77060. The Company has an operations office in Fort St. John, British Columbia and Gonzales, Texas and has exploration offices in Denver, Colorado and Tulsa, Oklahoma.

Business

The Company is in the business of identifying and acquiring oil and gas prospects in western Canada and the United States and exploring for, developing and producing crude oil and natural gas in these areas.

At October 31, 1980 Canadian reserves accounted for 98% of the Company's estimated proved natural gas reserves and 52% of the Company's estimated proved crude oil reserves. Most of the Company's Canadian drilling activities are conducted on prospects located in northeastern British Columbia and in south and central Alberta.

The Company began operations in the United States in 1977. Since then an increasing emphasis has been placed on U.S. activities. In 1980 these operations contributed 28.8% and 24.8% of the Company's revenue and net earnings, respectively. In the Company's opinion it is reasonable to anticipate greater economic returns from oil and gas exploration activities in the United States than in Canada. Therefore, further increases in the Company's activities in the United States are expected during 1981 relative to its Canadian operations. Approximately 50% of the Company's projected capital expenditures for the year ending October 31, 1981, including capital expenditures on behalf of drilling programs, will relate to activities in the United States. Its activities in the United States are expected to be primarily concentrated in the Gulf Coast areas of Texas and Louisiana and to a lesser extent in New Mexico, Oklahoma, Kansas, Arkansas and Montana.

To October 31, 1980 the Company, on behalf of itself and its drilling programs, had expended approximately $165.4 million on exploration and development in western Canada and the United States. It is anticipated that during the 1981 fiscal year the capital expenditures which the Company intends or is required to make to generate and acquire prospects and to explore for and develop oil and natural gas will exceed the expected revenue from operations. Accordingly, the Company's exploration and development program will depend on the availability of external sources of financing.

The Company has conducted a majority of its exploration and development activities through joint ventures with limited partnerships or corporations, or as a general partner of limited partnerships (collectively, the "drilling programs"). Under its arrangements with each drilling program, upon selecting properties which, in the Company's opinion, merit exploration and development as oil and gas prospects, the Company is required to offer varying interests in such prospects to the drilling program. The Company operates the prospect and receives a share of the revenues from the prospect, generally pays a proportionate share of any production facility costs after a well on the prospect is determined to be capable of commercial production, and in certain instances is required to contribute a portion of the drilling costs applicable to the prospect interest. See "Drilling Programs".

Operations

The basic exploration philosophy of the Company is to generate geological prospects in areas selected for their potential for hydrocarbons, proximity to pipelines and ease of access; to acquire interests in petroleum and natural gas rights through farmin or purchase; and to finance a substantial portion of the cost of exploration and development drilling through the use of funds from drilling programs, thereby reducing the Company's risk in drilling operations.

The Company attempts to reduce the risks inherent in the oil and gas industry by concentrating its operations in selected geographical areas in which its personnel have developed a familiarity with local geology and engineering, completion and production techniques. Most of the areas in which the Company operates are selected because of the geological likelihood of having multiple reservoirs which are prospectively oil and gas bearing, thereby minimizing risk.

The Company now participates directly in the cost of substantially all wells drilled by it on prospects where direct participation is available. To October 31, 1980 Czar had expended an aggregate of approximately $63.8 million of its own funds on exploration and development activities in Canada. The Company's interests in estimated reserves located in Canada are 219.0 Bcf of natural gas and 1,670.3 thousand Bbls of petroleum and natural gas liquids. See "Reserves".

Since the Company established an office in Houston in December, 1977, it has expended more than $15.7 million of its own funds on exploration and development activities in the United States to October 31, 1980 principally in the Gulf Coast areas of Texas and Louisiana. The Company's staff currently generates approximately 50% of the prospects the Company acquires. Although the risk of drilling non-productive wells in the United States is higher than in western Canada and it is difficult to assemble large blocks of land, the Company's experience has been that reserves, if discovered, are in greater demand than in Canada and the price available for the product is considerably higher. The Company's estimated reserves located in the United States are 2.4 Bcf of natural gas and 1,411.7 thousand Bbls of petroleum and natural gas liquids. See "Reserves".

Drilling Activities

During the five fiscal years ended October 31, 1980 and the first two months of fiscal 1981 the Company drilled or participated in drilling wells as follows:

Fiscal Year Ended October 31	Gas Wells	Oil Wells	Dry Holes	Total
1976	12	11	7	30
1977	33	11	10	54
1978	40	17	36	93
1979	74	23	14	111
1980	66	49	55	170
November and December, 1980	16	14	6	36

NOTE:

The classification of some of the wells in the table does not exactly correspond to the classification of wells set out under "Productive Properties" on page 7 since this table classifies certain wells as "Gas Wells" or "Oil Wells" which the Company has cased as potentially hydrocarbon bearing based on available geological data but without actually testing hydrocarbons in all cases. Without test or completion data, engineering evaluations as to proven or probable reserves have not as yet been conducted and such wells are not included in the evaluation reports referred to under "Reserves".

The Company's share of costs of land acquisition, exploration and development drilling and equipment and production facilities for the five fiscal years ended October 31, 1980 was as follows:

Fiscal Year Ended October 31	Land Acquisition (1)	Exploration and Development Drilling (2)	Equipment and Production Facilities
1976	$ 564,278	$ 13,980	$ 739,830
1977	1,720,239	526,263	1,981,184
1978	174,042	1,896,441	3,364,875
1979	4,589,839	8,618,315	2,745,389
1980	16,107,144	27,780,506	8,065,002

NOTES:

(1) The cost of land acquisition to the Company in each year has been netted against any recoveries from drilling programs for land sold to them in that year.

(2) Net of recovery of costs pursuant to the Copetrex agreements. See "Drilling Programs — Copetrex".

(3) In addition to the capital expenditures shown above, the Company also spent $86.5 million on these capital items on behalf of drilling programs with which it participated.

PRODUCTIVE PROPERTIES

The Company's oil and gas wells to October 31, 1980 are listed by area in the following table. Wells listed as "capped" are wells which the Company considers capable of production.

	Gross Wells (1)	Net Wells (1)	Status: Producing	Status: Capped (2)
Canada: Gas Wells				
Alberta	116	34.96	32	84
British Columbia	91	25.00	34	57
Canada: Oil Wells				
Alberta	65	15.48	57	8
British Columbia	5	1.45	4	1
United States: Gas Wells				
Texas	6	.47	5	1
Louisiana	2	.38	2	0
Oklahoma	1	.02	—	1
Montana	2	1.00	—	2
United States: Oil Wells				
Texas	17	8.32	13	4
Louisiana	1	.28	1	—
Arkansas	1	.35	1	—

NOTES:

(1) The term "gross wells" means the total number of wells in which the Company has an interest. "Net wells" means the sum of the Company's working interests in the gross wells, in each case before "payout" where payout has not yet occurred. "Payout" is the point at which the costs incurred in respect of the well have been recovered by the party who incurred these costs. In cases where the Company incurred the costs, its net well interest may decrease after payout, normally by 50% of its interest before payout. Conversely, if the Company did not incur the drilling costs, its net well interest may increase upon payout. The "net wells" calculation includes the net revenue interests of the Company payable by the Copetrex drilling programs. See "Drilling Programs — Copetrex".

(2) See "Risk Factors and Industry Conditions".

RESERVES

The following table summarizes the interest in net reserves and estimated future net revenues of the Company by way of its working interests and its net revenue interests in oil and gas properties as at October 31, 1980, derived with respect to Canadian reserves from a report dated January 9, 1981 by John Blain Engineering Ltd., Calgary, Alberta and with respect to United States reserves from a report dated December 30, 1980 by B. P. Huddleston & Co., Inc., Houston, Texas.

	Net Reserves		Estimated Future Net Revenues			
	Petroleum and Natural Gas Liquids (thousands of Bbls)	Natural Gas (Mmcf)	Undiscounted	Discounted 10%	Discounted 15%	Discounted 20%
Canada (1)						
Proved Developed	1,523.1	150,015.6	$547,631,595	$170,420,707	$114,215,863	$ 82,962,579
Proved Undeveloped	—	1,159.3	4,294,284	1,004,748	566,190	341,743
Probable	147.2	67,796.3	261,421,005	62,588,552	36,451,889	23,052,534
Total	1,670.3	218,971.2	$813,346,884	$234,014,007	$151,233,942	$106,356,856
United States (2)						
Proved Developed	856.9	1,469.7	$ 41,228,927	$ 29,773,356	$ 26,179,954	$ 23,386,498
Proved Undeveloped	554.8	974.0	24,656,692	16,673,232	14,047,589	11,988,207
Total	1,411.7	2,443.7	$ 65,885,619	$ 46,446,588	$ 40,227,543	$ 35,374,705
Total	3,082.0	221,414.9	$879,232,503	$280,460,595	$191,461,485	$141,731,561

The following notes set out certain assumptions which have been made by John Blain Engineering Ltd. ("Blain") and B. P. Huddleston & Co., Inc. ("Huddleston") in preparing their reports:

(1) Canadian Reserves

(a) All estimates of future net revenue include principal and interest payments on amounts owing to Czar pursuant to the agreements with Copetrex Oil & Gas Co. Ltd. ("Copetrex") and are after deduction for applicable royalties, direct taxes, operating costs and future development costs. Such development costs were estimated at $11,308,580. See "Drilling Programs — Copetrex". The net revenue interests have been treated as equivalent working interests with the exception that the allotment of drilling and completion costs has been adjusted to reflect the agreements with Copetrex. Indirect costs such as administrative overhead, miscellaneous expenses and income taxes have not been considered. **The discounted future net revenue values, calculated at rates of 10%, 15% and 20% per annum compounded annually to mid-year, are not to be construed as fair market values.**

(b) The following reserve classifications have been used by Blain in preparing its report:

"Proved Reserves" are the estimated economically recoverable quantities of crude oil or gas to be recovered from the Company's acreage. The existence of these reserves is based on engineering and geological data and the producibility of the reserves has been demonstrated by either flow tests, periods of production or by analogy with offset producing wells. "Probable Reserves" are additional reserves which are estimated to be recoverable through either additional drilling or increased recovery above that considered proved. "Probable Reserves" may be the reserves contained in existing wells whose producibility has not definitely been confirmed. The estimates of "Probable Reserves" are based on a realistic interpretation of the geological and engineering data available.

Whereas "Proved Developed Reserves" are those proved reserves which will be produced from existing wells or facilities, "Proved Undeveloped Reserves" are those which are not recoverable from existing wells or facilities or from those zones in existing wells which have been cased, but which can be recovered through the drilling of additional wells.

(c) The following price escalations have been used by Blain in its evaluation of Canadian reserves. These prices are net wellhead prices after removal of any direct taxes to be imposed by the federal government:

(i) For petroleum and natural gas liquids the price per barrel is $16.75 increasing to $18.25 in 1981, by $2.00 per year to $22.25 in 1983, by $4.00 in 1984 to $26.25, by $4.50 per year to $53.25 in 1990 and by 5% per year to $110.70 in 2005;

(ii) For Alberta natural gas the price per Mcf is $2.60 in 1980 and 1981, increasing by 20¢ in 1982 to $2.80, by 30¢ in 1983 to $3.10, by 40¢ in 1984 to $3.50, by 45¢ per year to $6.20 in 1990 and by 5% per year to $12.89 in 2005;

(iii) For British Columbia natural gas the price per Mcf is $1.22 in 1980, increasing by 20¢ per year to $3.22 in 1990 and by 5% per year to $6.69 in 2005; and

(iv) Operating costs have been increased by 7% per year for 10 years to 1990 and by 4% per year thereafter.

The price escalations used by Blain are not the same as those disclosed in the proposed National Energy Program by the federal government. Commencing in 1985, the price escalations used by Blain are significantly lower than those disclosed in the proposed National Energy Program by the federal government.

The federal government has initially set the proposed petroleum and gas revenue tax ("PGRT") at 8% of net operating revenues relating to the production of oil and gas. The PGRT has been deducted from production revenues. The federal government has indicated in the proposed National Energy Program tabled with the budget of October 28, 1980 that when price increases occur in the price of oil and natural gas faster than $1.00 per barrel every six months, it will be necessary to review the PGRT. In the opinion of Blain the federal government does not intend that the full benefit of price increases will reach the hands of the producer. In Blain's estimation it would be reasonable to anticipate increases in the PGRT.

In order to compensate for these anticipated increases in the PGRT, Blain has reduced the prices which Blain would otherwise assume would be appropriate for petroleum and natural gas over the relevant period. In Blain's opinion, the reduction in prices which Blain made compensates for the impact of anticipated increases in the PGRT.

In Blain's report, operating costs are based on actual costs or have been estimated by comparison with actual costs from similar properties; capital costs have been included to complete, equip and tie-in wells where applicable; future capital expenditures have been escalated similarly to operating costs.

(d) Czar recently signed a gas dedication contract with Consolidated Gathering Systems Limited and Sherritt Gordon Mines Limited for the dedication of up to approximately 212 billion cubic feet of natural gas and the sale of at least 75% of this amount. See "Sale of Production". For the purpose of the Blain report it has been assumed that most of the uncontracted gas wells drilled in southern Alberta will be placed on stream under the contract.

(e) In view of the present Canadian gas marketing situation and the large proportion of reserves included in Canadian wells which have not been placed on production, historical data with regard to the performance of certain wells is not available and the Blain report must be considered as only a preliminary appraisal of the wells. The Blain report is a summary of the results of individual net revenue projections prepared for each property. The complete report presents these net revenue forecasts along with a discussion of reservoir and production data.

Blain has stated that he did not inspect the properties nor conduct independent well tests. All factual data obtained from the files of the Company as well as the interests owned and royalties payable have been accepted as represented without verification by Blain.

(2) United States Reserves

(a) The following reserve classifications have been used by Huddleston in preparing its report:

"Proved Reserves" are those quantities of crude oil, natural gas and natural gas liquids which, upon analysis of geologic and engineering data, appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. "Proved Reserves" are limited to those quantities of oil and gas which can be expected, with little doubt, to be recoverable commercially at current prices and costs, under existing regulatory practices and with existing conventional equipment and operating methods. Depending upon their status of development, "Proved Reserves" are subdivided into "Proved Developed Reserves" and "Proved Undeveloped Reserves".

"Proved Developed Reserves" are proved reserves which can be expected to be recovered through existing wells with existing equipment and operating methods. This classification includes:

(i) "Proved Developed Producing Reserves". These are proved developed reserves which are expected to be produced from existing completion intervals now open for production in existing wells; and

(ii) "Proved Developed Nonproducing Reserves". These are proved developed reserves which exist behind the casing of existing wells, or at minor depths below the present bottom of such wells, which are expected to be produced through these wells in the predictable future, where the cost of making such oil and gas available for production should be relatively small compared to the cost of a new well.

Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery are included as "Proved Developed Reserves" only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.

"Proved Undeveloped Reserves" are proved reserves which are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units, which are reasonably certain of production when drilled. "Proved Reserves" for other undrilled units are claimed only where it can be demonstrated with certainty that there is continuity of production from an existing productive formation.

(b) The following are the average product prices weighted as a composite for all properties as used by Huddleston. In these prices an 8% annual escalation factor has been used on a lease by lease basis to a maximum of U.S. $60.00 per barrel (before deducting Windfall Profit Tax) and U.S. $10.00 per Mmbtu of gas for ten years, whichever occurred first.

	Oil, $/Bbl (U.S.)	Gas, $/Mmbtu (U.S.)
First Year — 1980	$33.32	$2.73
— 1981	37.63	2.78
Maximum	51.75	7.98
Average Over Life	44.80	4.48

(c) Operating expenses were derived from Czar U.S. profit-loss statements for each lease and adjusted for non-recurring costs where applicable and from comparable producing properties for those wells that have not produced. Severance and ad valorem taxes have been calculated as a percent of gross revenues and were deducted by Huddleston as an operating expense. These costs were escalated 8% per year for ten years and held constant thereafter.

(d) Cumulative production for all properties was approximately 4% of the estimated ultimate reserves as of October 31, 1980. Due to the lack of production histories, volumetric calculations and analogy to nearby production were utilized as the primary methods to estimate reserves. It is not unusual for estimates at this stage of depletion to be subject to greater variations than estimates prepared with the benefit of longer production histories. For the escalated product prices, the costs were equivalent to 28% of the gross revenues over life.

(e) Values were not assigned to nonproducing acreage and to the salvage value of surface and subsurface equipment. The costs to plug and abandon wells, general office overhead costs, federal income taxes and allowances for depreciation, depletion and amortization have not been deducted from estimated future revenues.

(f) **The estimated revenues and present value of these revenues are not represented as market value.** The estimates for individual leases should be considered in context with the overall or total estimated revenue. Actual individual lease performances will vary considerably from the projections, particularly in comparison to the total composite production from all properties. Huddleston has stated that it did not inspect the properties nor conduct independent well tests. Ownership and product prices and other factual data were accepted as represented by Czar U.S. Huddleston has stated that it generally tested the validity of these data and believes the information is correct.

PRODUCTION INFORMATION

During the five fiscal years ended October 31, 1980, the Company's production of crude oil, natural gas liquids and natural gas from Company operated and non-operated wells was as follows:

Canadian Production Year Ended October 31	Crude Oil and Natural Gas Liquids (Bbls)	Natural Gas (Mcf)	Revenue
1976	9,136	533,041	$ 253,483
1977	40,420	1,527,409	1,354,079
1978	69,500	2,057,639	2,197,382
1979	74,185	3,518,434	3,814,335
1980	120,729	3,832,062	4,914,776
	313,970	11,468,585	$12,534,055
United States Production Year Ended October 31			
1978	179	12,131	$ 69,473
1979	6,622	28,294	175,670
1980	68,519	39,413	2,276,238
	75,320	79,838	$ 2,521,381
TOTAL	389,290	11,548,423	$15,055,436

NOTE:

The interests of the Company include the Company's share of revenue from production from prospects acquired by limited partnerships of which Copetrex Oil & Gas Ltd. is the general partner, as well as the principal and interest payable with respect to property dispositions, after deductions of production expenses, where the amount of such payments is measured by production revenue. Reference is made to "Drilling Programs — Copetrex" and to the Consolidated Statement of Earnings of the Company.

SALE OF PRODUCTION

Canada

The Company has an interest in a total of 66 producing gas wells and 61 producing oil wells in Canada, of which 34 gas wells and 4 oil wells are located in northeastern British Columbia. The most significant properties in this area are the Monias, Birch and Fireweed properties. Based on results of production obtained during fiscal 1980, these properties accounted for approximately 13.7%, 6.0% and 6.4%, respectively, of the revenue of the Company from production and from principal and interest from property dispositions. In Alberta, the primary producing properties are located in the Twining area of central Alberta where the Company has an interest in 12 producing oil wells and in the Hussar area of southern Alberta where the Company has an interest in 21 gas wells, 11 of which are producing. Based on results of production obtained during fiscal 1980 the Twining and Hussar areas accounted for approximately 8.5% and 3.4%, respectively, of the revenue of the Company from production and from principal and interest from property dispositions.

The Company has entered into an agreement (the "Dedication Agreement") dated as of July 31, 1980 with Consolidated Gathering Systems Limited ("CGSL") and Sherritt Gordon Mines Limited ("Sherritt") to sell to CGSL, for delivery to Sherritt, the volumes of natural gas required by Sherritt for its planned ammonia manufacturing operation in Fort Saskatchewan, Alberta. The operation is planned to commence on February 1, 1983.

The Dedication Agreement provides for the dedication by the Company of natural gas produced by it and joint venture participants who agree to participate in the sale, from properties located in Alberta south of Township 39 (the "contract area"). The volumes of natural gas to be dedicated and held available for purchase by CGSL are 37 Mmcf per day for the period from February 1, 1983 to October 31, 1984 and 40 Mmcf per day from then until October 31, 1997. When gas sales purchase contracts are executed by the Company and its joint venture participants in respect to dedicated reserves, CGSL will have the obligation to take and pay for, or pay for, in each year no less than 75% of the volumes required to be dedicated in that year. If upon the termination of any of the gas purchase contracts, CGSL has paid for any gas which it has not received, the excess amount paid by CGSL is to be repaid, together with interest, over a period of 12 years commencing no later than the first date upon which the Company or other sellers sell gas from the dedicated but undelivered volumes. The Company and the other joint venture participants must pay interest, compounded annually, at a rate equal to the rate charged by the Company's bank in Calgary plus 1%, on such amounts to CGSL until the excess purchase price is repaid.

The price to be paid by CGSL for natural gas is the difference between a varying percentage of the base price and the amount of any interest charges at the rate referred to above which accrue pursuant to the take or pay provisions. The base price, which approximates the Alberta field gas price, is the Alberta border price for natural gas less the cost of transportation services. Until October 31, 1983 the applicable percentage under the gas purchase agreements is 70% of the base price. From November 1, 1983 to October 31, 1992 the applicable percentage will increase by 1% per year to 80% of the base price. The percentage will remain constant at this level for the period from November 1, 1992 to October 31, 1997. From then until October 31, 2002 (assuming CGSL exercises its option to extend the life of the Dedication Agreement) the percentage will be 85% of the base price. The Company and the various joint venture participants remain entitled to receive the gas export rebate which currently approximates 87¢ per Mcf of natural gas.

The obligation of the Company to dedicate natural gas, and the corresponding benefits of the gas purchase agreements, are presently shared by certain of the participants with the Company in its various joint venture operations. The Company is currently determining whether various of its other joint venture participants wish to share these obligations and benefits.

The Company has undertaken to exercise its best efforts to locate within the contract area and bring on stream, additional natural gas so that over the contract period at least 212 Bcf of deliverable natural gas are dedicated to CGSL by the Company and its joint venture participants. It is estimated that the Company's share of this obligation will be 15% to 20% or 32 Bcf to 42 Bcf of natural gas. The Company and various participants in joint ventures with the Company who have committed their joint venture reserves to the sale currently have proven and probable reserves of natural gas within the contract area of approximately 150 Bcf.

Under the Dedication Agreement, the Company has the obligation to install the necessary production facilities to bring the dedicated reserves on stream. The Company expects that it will be able to negotiate a satisfactory agreement with CGSL under which CGSL will install the necessary production facilities and charge a through-put fee to the Company. If such an agreement is not entered into, however, it will be necessary for the Company to incur these expenditures itself. In the report prepared by John Blain Engineering Ltd. which estimates the Company's future Canadian reserves, the cost of bringing reserves into production for purposes of the Dedication Agreement has been taken into account in calculating the estimated future net revenue that may be derived from its Canadian reserves.

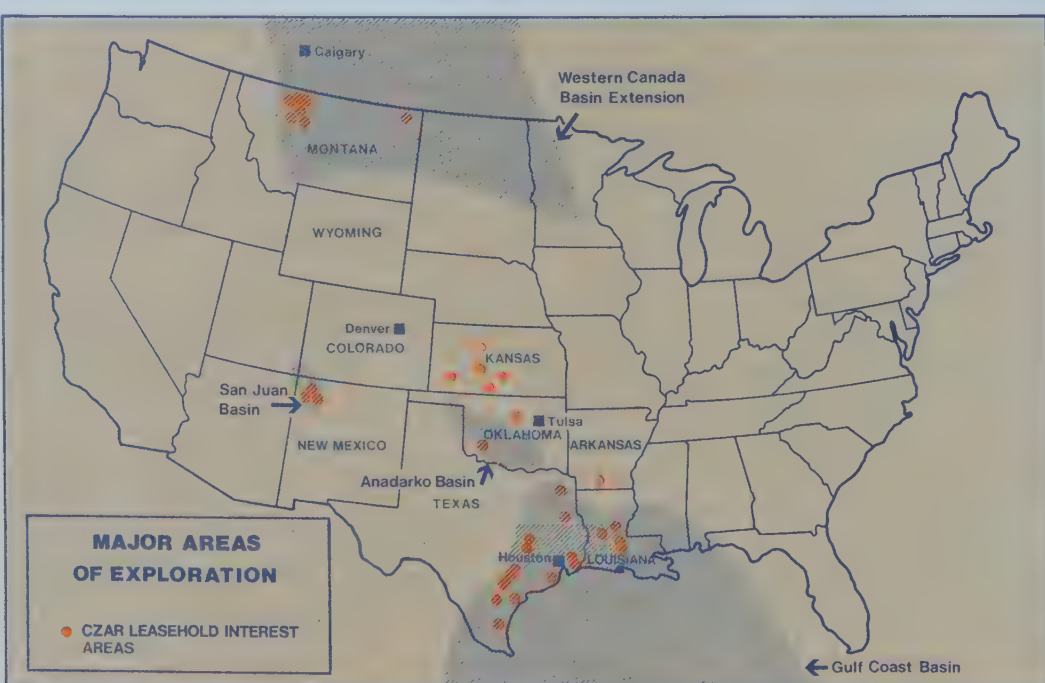
In the interim period (until February 1, 1983), the Company and certain of its joint venture participants have entered into gas field purchase contracts, on a take or pay basis, for the sale to CGSL of 5 Mmcf of natural gas per day at a price equal to that payable to the Company under the Dedication Agreement for the period from February 1, 1983 to October 31, 1983. The Company's share of this commitment is 1.181 Mmcf per day. Gas is currently being delivered at the rate of 5 Mmcf per day under these contracts. CGSL has indicated to the Company that if additional natural gas is available, it may be prepared to purchase up to an aggregate of 8.9 Mmcf of gas per day during the interim period.

United States

The Company's primary United States producing properties are located in the Austin Chalk trend of the Gulf Coast area of Texas where the Company has an interest in 12 producing oil wells and 5 wells which preliminary testing indicate may be prospectively oil bearing. These properties accounted for approximately 26.1% of the net production revenue of the Company during fiscal 1980.

Substantially all of the Company's oil production in the United States may be sold at world prices. The Company currently receives approximately $35 U.S. per barrel. All of the Company's contracts for the sale of oil in the United States can be terminated by the Company or by the purchaser on at least 30 days' notice. Therefore, under current market conditions characterized by rising prices for oil, the Company is in a position to take advantage of all price increases.

The Company's United States gas production is sold under seven gas sales contracts varying in length from five to twenty years. Prices available to the Company for this production are governed by federal regulations which establish classifications for wells and, for each classification, a maximum allowable price which a producer and purchaser may negotiate. In each of its contracts the Company has the right to receive the maximum allowable price for the particular category of well. Prices currently being received under these contracts range from $1.90 U.S. per Mcf to $2.52 U.S. per Mcf.



UNDEVELOPED ACREAGE

The following table provides a breakdown of the Company's undeveloped gross and net acreage holdings by area as of October 31, 1980 for United States acreage and as at December 31, 1980 for Canadian acreage. The Company continues to hold virtually all of this acreage and has acquired additional acreage in the course of its continuing exploration program. The acreage set forth in the table includes all acreage held by the Company at such date excluding spacing units which had a producing well or a well capable of production located on it.

The undeveloped acreage of the Company in Canada as at December 31, 1980 had a replacement cost of approximately $50.9 million based upon a report dated January 14, 1981 prepared by Seaton-Jordan & Associates Ltd., land appraisers of Calgary, Alberta. Replacement cost is defined as the price which Seaton-Jordan & Associates Ltd. would recommend that a client bid at a Crown sale of leases of petroleum and natural gas rights.

The undeveloped acreage of the Company in the United States as at October 31, 1980 had a replacement cost as at January 15, 1981 of approximately $3.7 million based upon a report dated January 16, 1981 prepared by Kenneth W. Lane, land consultant, of Houston, Texas. Replacement cost is defined as the price which, based on the most recent acreage acquisition activity in the area in which Czar U.S. holds leasehold interests, Czar U.S. would be advised by Mr. Lane to pay in order to renew, at January 15, 1981, its current leasehold interest.

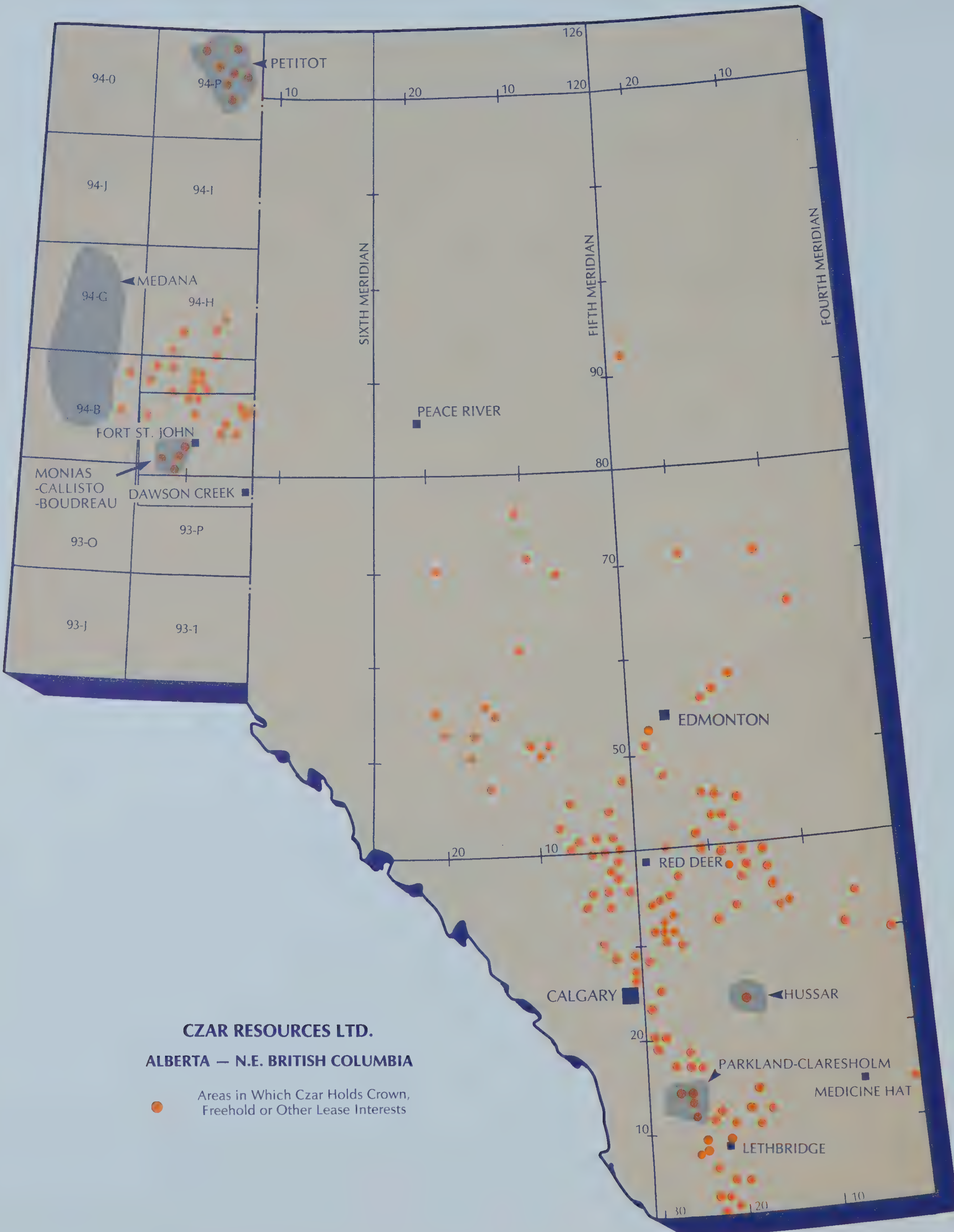
	Gross Acreage (1)	Net Acreage (1) (2)
Canada		
Alberta	512,069	180,302
British Columbia	377,105	104,412
	889,174	284,714
United States		
Louisiana	3,473	1,118
Texas	51,949	15,233
Montana	13,499	10,770
New Mexico	14,811	1,081
	83,732	28,202
TOTAL	972,906	312,916

NOTES:

(1) Gross acreage represents the acreage in which the Company has varying interests. Net acreage represents the aggregate of the interests of the Company (other than a royalty interest) in the gross acreage. In the case of reservations, permits and licences, these figures are after giving effect to future reversions to the government involved. Certain interests in net acreage may decrease after the Company has recovered the cost of initial wells incurred by it or may increase after others have incurred the cost of initial wells incurred by them.

(2) Certain of the net acreage in Canada is subject to agreements which require the Company to offer its drilling programs an opportunity to participate in the drilling of any wells on, and to acquire a working interest in, prospects delineated as part of prescribed areas of mutual interest. See "Drilling Programs".

(3) During fiscal 1980 the Company paid rentals of $392,090 to maintain its undeveloped acreage.



CZAR RESOURCES LTD.

ALBERTA — N.E. BRITISH COLUMBIA

● Areas in Which Czar Holds Crown, Freehold or Other Lease Interests

EXPLORATION AND DEVELOPMENT PROGRAM

The Company intends to conduct a balanced North American program of exploration and development so as to strengthen its cash flow, earn acreage positions where large reserve discoveries may be made and to build on its base of successful exploration in the United States, expanding and diversifying its U.S. drilling program in Texas, Oklahoma, New Mexico, Montana, Kansas and Arkansas.

Canadian Activities

The Company has offices in Calgary, Alberta and Fort St. John, British Columbia employing a staff of 76 persons including 41 professionals.

Over the next two years, the Company will concentrate its exploration and development activities on prospects likely to generate an early cash flow to the Company. Accordingly, the Company will select areas prospective for oil reserves and areas where gas reserves, if discovered, can be included in its current gas sales contracts.

As part of this program, the Company will be drilling up to 4 wells in the Parkland-Claresholm area, southeast of Calgary, where the Company has interests in 8 gas wells with proven reserves and where additional gas reserves can be made part of the sales contract with CGSL. In the central Alberta areas of Manito-Leahurst, approximately 15 exploratory and development wells on discrete low risk prospects will be drilled within the Sherritt contract area.

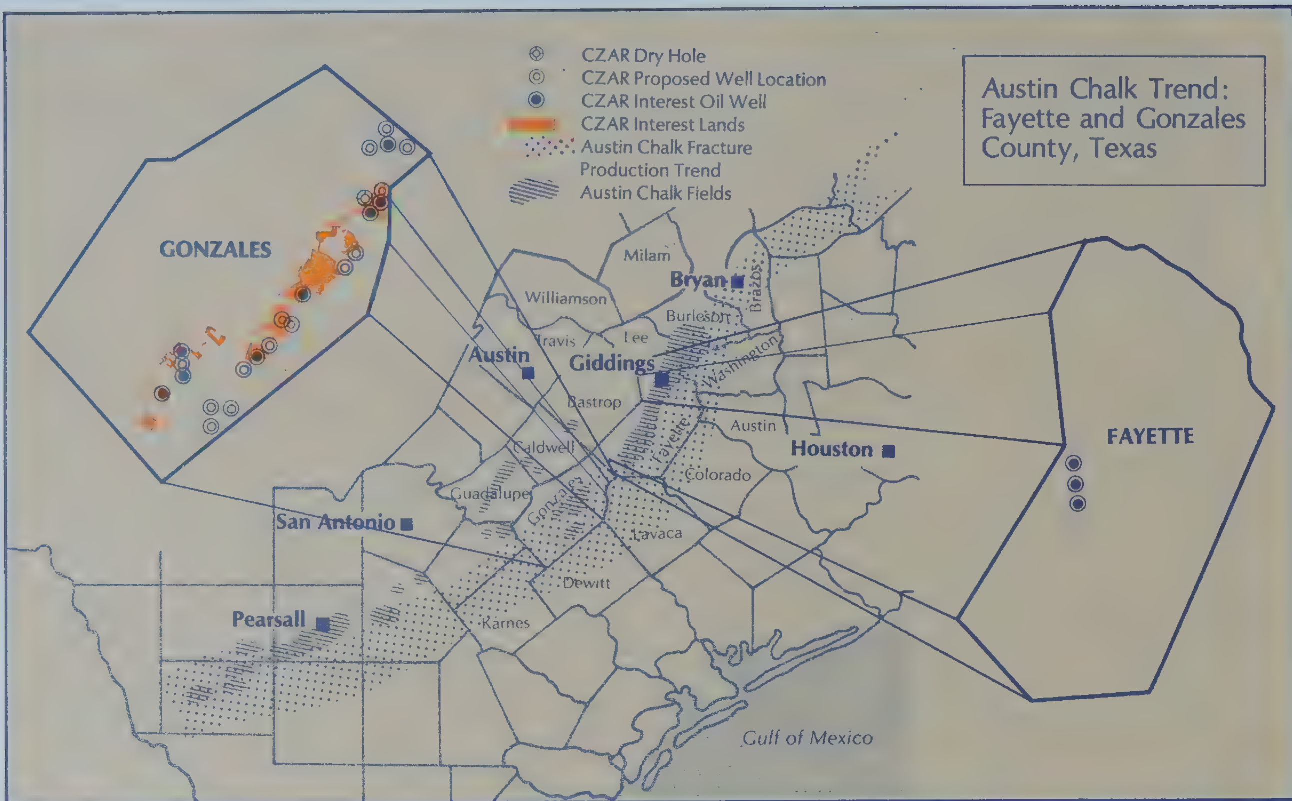
At Hussar, approximately 60 miles northeast of Parkland-Claresholm, the Company has an interest in 21 wells, 11 of which are producing, and plans an additional 6 wells to ensure maximum deliverability under the terms of an existing gas sales contract.

The Company will continue development drilling in the Monias-Callisto-Boudreau areas of northeast British Columiba near Fort St. John. In these areas, the Company has interests in 14 gas wells, 7 of which are currently on production. The Company may drill up to 4 development wells in these areas in fiscal 1981 which, if successful, may be included in the Company's existing gas sales contract when reservoir drainage can be proven pursuant to the recently approved British Columbia drainage regulations. Existing wells are currently being pressure monitored to prove that continuity of reservoir does in fact occur between the Callisto and Monias areas. Activities by Czar and its industry participants over the last year have given rise to substantial increases in the asset base of the Company as a result of the discovery of new reservoirs. The Company feels that it is prudent to continue to drill for increased reserves even though these may not be brought on stream in the immediate future. This drilling activity will preserve important acreage positions of the Company in these areas.

While an emphasis will be placed on early cash flow, the Company will commit a portion of its planned corporate expenditures to other areas where cash flow may be delayed but where reserve discoveries may be made at relatively low cost. An example of this is the area near Petitot in northern British Columbia where the Company has drilled 25 wells with a success rate of 80%. The Company has found in this area proven and probable reserves with estimated future net revenue to Czar of $21.2 million undiscounted and $2.6 million discounted at a 15% rate. The Company has interests in approximately 144,000 gross acres in this general area and has the option to earn, by drilling, interests in a further 283,000 gross acres. The Company believes it is prudent to earn its interest in this acreage and anticipates drilling 8 to 12 wells during the 1981-1982 winter drilling season.

The Company believes a similar situation exists at Medana, northwest of Fort St. John, where the Company has undertaken to drill 7 wells during fiscal 1981 on a 150,000 acre block farmed in from Canadian Hunter Exploration Ltd.

The extent of the Company's drilling in any area will depend on the amount and the structure of the drilling funds made available to the Company for spending on behalf of its drilling programs. Should drilling funds be available, however, the Company together with these drilling programs may expend up to $75 million in Canada over the next two years and may drill up to 200 wells.



United States Activities

As indicated earlier, the Company commenced operations in the United States in 1977. Since then, the Company has substantially expanded its U.S. operations and now has exploration offices in Houston, Denver and Tulsa employing a staff of 50 persons including 27 professionals.

As at October 31, 1979 the Company's U.S. oil and gas reserves accounted for approximately 1% of its total reserves. During fiscal 1980 the Company spent $13.2 million U.S. on its own behalf and $4.6 million U.S. on behalf of drilling programs and drilled 35 wells in the United States with a success rate of 71%. By October 31, 1980 the Company had U.S. oil and gas reserves with estimated future net revenues therefrom, discounted at 15%, of more than $40 million. At this date, U.S. reserves accounted for 48% of the Company's estimated proved crude oil reserves and 2% of the Company's estimated proved natural gas reserves. See "Reserves".

The Company intends to continue to expand its exploration and development activities in the United States. In fiscal 1981, it will expend on such activities the uncommitted portion of the $20 million U.S. raised in 1980 by Europa Petroleum, Inc., one of the Company's United States joint venture participants. A registration statement was filed on February 10, 1981 with the United States Securities and Exchange Commission for a proposed public offering in the United States of up to $20 million U.S. of interests in two limited partnerships. As a result of this and the anticipated cash flow of Czar U.S., the Company may spend up to approximately $45 million U.S. in fiscal 1981 on its own behalf and on behalf of drilling programs in the United States.

A primary focus of the Company's U.S. activities will be in the Austin Chalk trend of the Gulf Coast, particularly in Gonzales and Fayette counties of Texas. Czar recognized the potential of this prospect area in 1979 and has since acquired an interest in approximately 30,000 gross acres (approximately 10,000 net acres). Utilizing technology developed in recent years, the Company has to date drilled, as operator, 10 wells in this trend, all of which have been completed as producing oil wells. It is estimated that these wells account for 1,000,000 Bbls or 32% of the Company's estimated crude oil reserves. Nine additional wells are currently being drilled or have been drilled in this area, five of which have initially tested as prospectively oil bearing.

While there is a tendency for wells in the Austin Chalk trend to decline rapidly in production, the wells drilled by the Company, after suffering some initial decline, are now producing stable rates of flow ranging from approximately 50 Bbls to approximately 200 Bbls per day. Estimated undiscounted future net revenue as at October 31, 1980 attributed to the Company's share of its proven oil reserves in the Austin Chalk trend was estimated to be $43 million U.S. and the cash flow to the Company in January, 1981 from producing wells in the Austin Chalk trend amounted to $500,000 U.S. after royalties, Windfall Profit Tax and operating expenses.

The Company has contracted to drill approximately 15 additional wells on this trend during fiscal 1981. While there can be no assurance that Czar's success rate in the Austin Chalk trend will continue, it is anticipated that the Company will drill is excess of 100 wells on its Austin Chalk acreage over the next 2½ years which, based upon industry drilling results in the Austin Chalk trend to date, could potentially increase Czar's future oil reserves in the Austin Chalk trend by approximately 5,000,000 Bbls or approximately 600%. The Company intends to finance a portion of its development activities in these wells through other joint venture industry participants which will result in a decrease in its net interest in these wells.

Other areas of activity in the United States include Oklahoma, New Mexico and Montana.

Czar U.S. is currently participating in a 9 well program in the Anadarko Basin of Oklahoma as a result of the estimated reserves assigned to wells previously drilled in this area (ranging from 20 Bcf to 50 Bcf per well) and a contracted gas price of $6.75 U.S. per Mcf. Further exploration during 1981 is planned for the Anadarko Basin and central Oklahoma.

In the San Juan Basin of New Mexico, Czar U.S. had acquired by the end of fiscal 1980 interests in approximately 15,000 gross acres (approximately 1,000 net acres) in order to test a geological formation similar in nature to the Austin Chalk trend in Texas. Czar has committed to drill 5 wells in this area, all of which will be completed by the end of fiscal 1981. If these drilling activities are successful, Czar U.S. estimates that it will drill an additional 60 wells in this area within the next five years.

In Montana, Czar U.S. has commenced the development of 5 prospects, 3 of which are believed to be extensions of tested geological formations known to exist in Alberta. Czar U.S. has drilled an exploratory well on one of the remaining two prospects and log and core analysis indicates the well to be productive. The Company has acquired 14,000 gross acres and 11,000 net acres in Montana.

Funding of Exploration and Development Expenditures

The Company will continue to conduct most of its exploration and development activities in fiscal 1981 through drilling programs with publicly and privately held limited partnerships and investors. By this means, the Company intends to manage a large expenditure program while keeping its own corporate expenditures to moderate levels and earning a share of net revenues of up to 20% more than its corporate share of the costs.

The Company anticipates obtaining up to $100 million from drilling fund investors in 1981 to conduct drilling activities in Canada and the United States. If $100 million is obtained, the financial commitments of the Company in 1981 and early 1982 would total approximately $20 million. The Company's existing cash flow and bank lines of credit are sufficient to meet these and other financial obligations anticipated during this period.

The Company intends, where possible, to concentrate its exploration and development expenditures on prospects likely to generate an early cash flow to the Company. The Company may also take advantage of opportunities which may arise from time to time to sell modest amounts of its developed properties to realize profits thereon, provided such sales can be made on terms considered attractive to the Company. The Company believes these policies will allow it to avoid an increase in its level of bank indebtedness.

DRILLING PROGRAMS

The Company conducts a majority of its exploration and development activities through certain arrangements with drilling programs, primarily joint ventures with publicly and privately held limited partnerships and corporations. Aurora Energy Fund Ltd. ("Aurora Ltd.") or its wholly-owned subsidiary Aurora Energy Fund, Inc. ("Aurora, Inc.") (collectively, "Aurora") is the general partner and manages the business and affairs of ten such drilling programs. Officers and directors of the Company, including Robert W. Lamond, the Chairman of the Board and a Director of the Company, own a majority of the capital stock of Aurora Ltd. Copetrex Oil & Gas Co. Ltd. ("Copetrex"), an independent funding source, is the general partner of ten limited partnerships which have entered into joint ventures with the Company.

The Company has entered into arrangements with the following drilling programs:

(i) **Canadian Aurora Programs.** The Company is a participant in joint ventures with six limited partnerships (the "Canadian Aurora Programs") of which Aurora Ltd. is the general partner. The Canadian Aurora Programs have engaged in drilling and production of oil and gas in Canada through joint ventures with the Company since 1977. Net proceeds from the sale of limited partnership interests in the Canadian Aurora Programs have totalled $59.9 million, of which $31.2 million was raised in 1980.

Under all the Canadian Aurora Programs, as compensation for the generation, acquisition, exploration, development and operation of the prospects, the Company receives a carried interest equal to 25% of the limited partnerships' interest in all prospects subject to the Company being required to pay at least 8.75% of the costs incurred by four of the limited partnerships. All of the Canadian Aurora Agreements provide that the Company must bear its proportionate share of production facility costs.

Beginning in 1981 in respect of Aurora 78-79 Energy Program, Aurora-Czar 79-80 Energy Program and Aurora-Venus 79-80 Energy Program and 1982 in respect of Aurora-Czar 80-81 Energy Program, the Company may be required to purchase interests in oil and gas properties to enable the limited partnerships to finance the retirement of up to a maximum of 10% annually of the limited partnership interests initially issued by the programs. Upon the formation of Aurora Czar Energy Company Ltd. referred to below, the obligation in respect of Aurora 78-79 Energy Program and Aurora-Czar 79-80 Energy Program will be extinguished.

(ii) **Proposed Reorganization of Certain Canadian Aurora Programs.** It is proposed to reorganize all the publicly held Canadian Aurora Programs, other than Aurora-Venus 79-80 Energy Program and other than Aurora-Czar 80-81 Energy Program which has not yet completed its exploration program and which cannot yet be fairly evaluated. Subject to the requisite approval of limited partners, the limited partners' interests in the reorganized programs are to be sold to a new company, Aurora Czar Energy Company Ltd. ("ACE"), in consideration for common shares of ACE. ACE plans to offer a maximum of $40 million and a minimum of $10 million of shares for sale to the Canadian public in 1981. Approximately 70% of the net proceeds, if any, of this offering will be used to finance exploration and development of oil and gas prospects under a joint venture agreement with the Company.

Under the proposed joint venture agreement with ACE, the Company will be required to offer ACE a percentage designated by the Company of substantially all prospect interests acquired by the Company in Canada until the net proceeds raised on the formation of ACE have been expended. Such percentage is required to be not less than 25% of the interest available to Czar in the prospects. Interests must be offered to ACE at the lower of the Company's acquisition costs (adjusted to reflect the carrying costs of the prospect interest and allocable staff and other geological and geophysical costs) or fair market value.

Under this proposed joint venture agreement, drilling activities on prospects derived from properties purchased by ACE from the Canadian Aurora Programs will continue to be subject to the same cost sharing and revenue sharing provisions as applied while they were owned by the Canadian Aurora Programs. With respect to new prospects (other than prospects within areas of mutual interest relating to the existing properties), the Company will receive 33% of the revenues from any such prospect and will be obliged to pay 14% of exploration and development costs and 33% of operating costs.

(iii) **United States Aurora Programs.** Aurora, Inc. and Czar U.S. are the general partners of two limited partnerships which were organized in 1979 and 1980 to acquire prospects in the continental United States, primarily Texas, Louisiana and Montana and to explore for, develop and produce oil and gas

therefrom. The United States Aurora Programs received net proceeds of $5,882,825 U.S. from offerings of limited partnership interests to United States investors.

Czar U.S. serves as operator of most prospects acquired by the United States Aurora Programs. Czar U.S. generally bears only those costs in connection with the drilling and completion of wells that must be capitalized for United States federal income tax purposes. In addition, in the United States Aurora Program organized in 1980, if the capitalized drilling costs exceed 35% of aggregate drilling costs incurred for any well, 65% of such excess capitalized drilling costs are borne by the limited partners. Czar U.S. is allocated 37% of the net revenues (after deduction of operating costs) of the 1979 United States Aurora Program before payout and 45% of such revenues after payout. The comparable percentages for the 1980 United States Aurora Program are 29% before 150% of payout is achieved and 49% after 150% of payout is achieved. It is not anticipated that Czar U.S. will offer these Programs interests in additional prospects.

On February 10, 1981 Czar U.S. and Aurora, Inc. filed a registration statement for a proposed public offering in the United States of up to $20 million U.S. of limited partnership interests in Czar-Aurora 1981-A Limited Partnership and Czar-Aurora 1981-B Limited Partnership. These offerings are expected to close in June and October, 1981, respectively. While the Company expects these offerings to be successful, there is no assurance that any funds will be raised.

(iv) **Europa.** Europa Petroleum, Inc. ("Europa") was organized in 1980 to acquire oil and gas prospects in the United States and to explore for, develop and produce oil and gas on these prospects through a joint venture with Czar U.S. The business and affairs of Europa are managed by Aurora, Inc. Europa concluded an offering of $20 million U.S. of common shares to investors outside the United States and Canada in December, 1980. The net proceeds of the offering, before expenses, were $18,600,000 U.S.

Under the joint venture agreement between Czar U.S. and Europa, Czar U.S. is required, until December 31, 1983, subject to Europa having available financing, to offer Europa an interest in all oil and gas prospects in the United States in which Czar U.S. participates, other than certain prospects in prescribed areas where Czar U.S. has conducted activities with other drilling programs. The interest offered to Europa must be at least 25% of the interest available to Czar U.S. and not more than a 50% working interest in the prospect. Interests must be offered to Europa at the lower of the acquisition cost (adjusted to reflect the carrying costs of the prospect interest and allocable staff and other geological and geophysical costs) or fair market value. Czar U.S. will receive 20% of all revenues resulting from the operations conducted pursuant to the joint venture agreement and will pay a share of operating costs proportional to its working interest in respect of each joint venture prospect. Europa pays all other costs.

(v) **Shackleton.** Shackleton Petroleum Corporation and its U.S. subsidiary (collectively, "Shackleton") and the Company entered into a joint venture in 1980 to acquire oil and gas prospects in Canada and the United States through to June, 1983 and to explore for, develop and produce oil and gas on these prospects. The business and affairs of Shackleton are managed by Aurora. Shackleton on August 13, 1980 completed an offering of shares, principally in Canada and the United Kingdom, from which Shackleton has received net proceeds of $9,875,000 to be utilized on exploration and development activities pursuant to its joint venture with the Company. Approximately two-thirds of these funds will be expended in Canada and one-third in the United States.

Under the joint venture agreement with Shackleton, the Company is required until June, 1983, subject to Shackleton having available financing, to offer Shackleton an interest in substantially all new prospects in Canada and the United States in which the company participates. Shackleton must be offered 12.5% of the interest available to the Company in Canadian prospects and 20% of the interest available to Czar U.S. in U.S. prospects, respectively. Interests must be offered to Shackleton at the lower of the Company's acquisition cost (adjusted to reflect the carrying costs of the prospect interest and allocable staff and other geological and geophysical costs) or fair market value. The Company will receive 20% of all revenue resulting from the joint venture and will pay a share of operating costs proportional to its working interest in respect of each joint venture prospect. Shackleton pays all other costs.

(vi) **Copetrex.** The Company has entered into joint ventures with ten limited partnerships of which the general partner is Copetrex Oil & Gas Co. Ltd. ("Copetrex"). Eight of these joint ventures were organized to explore in Canada and two in the United States (collectively, the "Copetrex Programs"). The limited partners of the Copetrex Programs are West German investors. The Copetrex Programs, which con-

tributed a total of $40.3 million to joint ventures with the Company, drilled for gas and oil in Canada between 1974 and 1979 and in the United States in 1978 and 1979. The Company does not expect the Copetrex Programs to participate in the Company's exploration and development program in 1981 to any material extent.

Under its agreements with the Copetrex Programs, the Company has sold these Programs various working interests in oil and gas prospects. The purchase price for these interests has been payable, in part, on the date of acceptance of the prospects by Copetrex, with the balance together with interest thereon payable over a 26-year period. The Company has agreed to postpone certain of these payments because the interests to which they relate consist principally of interests in shut-in gas wells, gas production from which is not presently marketable. The outstanding balance of the purchase price is payable in fixed annual installments as to 5% for the first twelve years, 4% for the next five years, 3% for the next four years, 2% for the next three years and 1% for the remaining two years. Interest on the outstanding balance of the purchase price is payable in each year in an amount equivalent to a prescribed percentage of "net revenue" less any installment payment on the purchase price in that year. "Net revenue" for these purposes means the gross revenue less deduction of applicable royalties, direct taxes and operating costs. In addition to these payments relating to the purchase price of the interests sold to the Copetrex Programs, the Company has a direct interest in the net revenue from all wells on any prospect acquired from the Company by the Copetrex Programs in Canada.

By agreement dated May 11, 1979, Copetrex determined that it no longer wishes its limited partnerships to participate in new prospects in the United States. By agreement dated May 11, 1979, Copetrex has also confirmed to the Company that, until Copetrex advises the Company otherwise, the Company is no longer obligated to continue to offer participation in prospects outside areas of mutual interest.

CONSOLIDATED CAPITALIZATION

	Authorized or to be Authorized	Outstanding on October 31, 1980	Outstanding on January 31, 1981	Outstanding on January 31, 1981 after giving effect to this issue
Current Bank Debt (1)				
Czar Resources Ltd.	$50,000,000	$45,962,491	$45,350,000 (2)	•
Czar Resources Inc.	$ 4,819,960	$ 1,731,145	$ 4,702,400 (2)	$4,702,400 (2)
First Preference Shares par value $25 each	600,000 shs.			
7½% Cumulative Redeemable Convertible First Preference Shares, Series A	320,000 shs.	—	—	—
Common Shares without nominal or par value (3)	15,000,000 shs.	9,613,553 shs.	9,613,553 shs.	• shs.
		($36,228,940)	($36,228,940)	($ •)

NOTES:

(1) The Company has a $4.8 million line of credit with its United States bank and has recently increased its line of credit with its Canadian bank to $50 million. The term of the Canadian line of credit extends to May 31, 1981, subject to review in the normal course of business. The bank has, however, indicated that it is its intention to extend its support to the Company on an on-going basis. The Company has agreed, in connection with this line of credit, that it will use its best efforts to complete the offering of Common Shares pursuant to this prospectus in early 1981 and that it will not give a guarantee to, or enter into any agreement containing any negative covenants with, any other financial institution and that it will not encumber any of its assets or dispose of its resource properties (other than to its joint venture participants in the normal course of business) without, in each case, the bank's consent. The indebtedness of the Company under this line of credit is or is required to be secured by an assignment of accounts receivable and certain of the Company's petroleum and natural gas properties and its revenue interest therein, limited guarantees from certain Copetrex Programs collaterally secured by assignments of certain petroleum and natural gas properties forming part of such Copetrex Programs and assignments of certain gas purchase contracts. All of the terms and conditions relating to the Canadian line of credit will be set forth in an oil and gas loan agreement to be settled between the Company and the bank.

(2) This amount does not include cheques issued but uncashed as at January 31, 1981 as the Company has not completed the preparation of its internal financial statements for January, 1981.

(3) As at October 31, 1980, 448,310 Common Shares were reserved pursuant to the terms of options granted to employees, officers and directors of the Company and one other person. As at February 11, 1981 there were 9,613,553 outstanding Common Shares. See Notes 3(b), (c) and (d) to the Consolidated Financial Statements.

(4) As at October 31, 1980 retained earnings were $4,565,083.

(5) See Note 5 to the Consolidated Financial Statements as to the extent of obligations arising by virtue of leases.

(6) • Common Shares will be reserved for issuance upon the exercise of the • Common Share Purchase Warrants to be outstanding after completion of this offering.

USE OF PROCEEDS

The estimated net proceeds to be received by the Company from the sale of the Common Shares offered hereby will be approximately $ • after deducting the underwriting commission and estimated expenses of approximately $ • relating to the issue. These proceeds will be applied to reduce outstanding bank borrowings in Canada ($45,350,000 at January 31, 1981) incurred by the Company primarily to acquire interests in oil and gas prospects and to explore for, develop and produce oil and gas.

The Company has been granted a line of credit with its Canadian bank of $50 million and a $4.8 million line of credit with its United States bank. After application of the net proceeds of the offering to the repayment of the Canadian bank indebtedness, the Company expects to have available $ • million under its line of credit with its Canadian bank. See "Exploration and Development Program".

DETAILS OF THE OFFERING

The Company offers pursuant to this prospectus • Common Shares carrying the right to receive • Common Share Purchase Warrants.

Description of the Common Shares

The Common Shares of the Company rank junior to the First Preference Shares of the Company both as to the return of capital and as to the payment of dividends and are entitled to one vote per Common Share. There are no First Preference Shares of the Company outstanding. All of the Common Shares outstanding are fully paid and non-assessable and the Common Shares offered hereby will, when issued, be fully paid and non-assessable. The Common Shares are listed on the Toronto and Alberta Stock Exchanges.

Description of the Common Share Purchase Warrants

The Common Share Purchase Warrants (the "Warrants") entitling the registered holders thereof to purchase an aggregate of • Common Shares of the Company, as presently constituted, will be issued by the Company in accordance with the provisions of an indenture (the "Warrant Indenture") to be dated • , 1981 between the Company and The Canada Trust Company, as trustee.

The Warrant Indenture will provide that holders of record of the Common Shares offered hereby at the close of business on • , 1981 will receive by registered mail one Warrant in bearer form for each • Common Shares held. • Warrants will entitle the holder to purchase one Common Share of the Company at any time after receipt and up to the close of business on • , 198• at the price of $ • per share and thereafter and up to the close of business on • , 198• at the price of $ • per share.

The Warrants will be transferable by delivery. Prior to the close of business on • , 1981, the right of a holder of Common Shares offered hereby to receive a Warrant shall not be transferable separately but only by and in connection with a transfer of the Common Shares offered hereby to which such Warrant relates, and any transfer of such Common Shares on or prior to such date shall constitute a transfer of the right to receive such Warrant.

The Warrant Indenture will provide that the exercise price is subject to adjustment in certain events including:

(a) the subdivision, consolidation or reclassification of the Common Shares or the issue of Common Shares to the holders of Common Shares by way of a stock dividend, other than an issue of Com-

mon Shares to such holders as a dividend paid in the ordinary course (as such term will be defined in the Warrant Indenture);

(b) the issue of rights or warrants to all or substantially all the holders of Common Shares entitling them within a period of 45 days to acquire Common Shares (or securities convertible into Common Shares) at less than 95% of the Current Market Price of the Common Shares; and

(c) the distribution to all or substantially all the holders of Common Shares of shares of any other class or of rights, options or warrants (other than those referred to above) or of evidences of indebtedness or of assets excluding dividends paid in the ordinary course (as such term will be defined in the Warrant Indenture).

The term "Current Market Price" will be defined in the Warrant Indenture to mean the weighted average price per share for the Common Shares for any 30 consecutive trading days (selected by the Company) commencing not more than 45 trading days before such date on The Toronto Stock Exchange, determined by dividing the aggregate sale price of all such shares sold on the said exchange during the said 30 consecutive trading days by the total number of such shares so sold.

No adjustment in the purchase price will be required to be made (a) unless the cumulative effect of such adjustment or adjustments would change the purchase price by at least 1% or (b) in respect of the issue of Common Shares pursuant to (i) the exercise of the Warrants, or (ii) any stock purchase or option plan for officers or employees of the Company.

The Company will covenant in the Warrant Indenture that it will at all times reserve sufficient of its unissued Common Shares to satisfy the exercise of the Warrants.

The Company will also covenant in the Warrant Indenture that, during the period in which the Warrants are exercisable, it will give public notice before taking certain actions, including the payment of a stock dividend on its Common Shares, the making of any other distribution on its Common Shares other than cash dividends, or the issue of rights to the holders of its Common Shares, such notice to be given at least 21 days prior to the record date for the determination of the shareholders entitled to such dividend, distribution or issue. Such notice need only set forth such particulars of such dividend, distribution or issue as shall have been determined at the date the notice is given.

Income Tax Considerations

There are certain federal Canadian income tax consequences to initial purchasers resident in Canada who hold the Common Shares and Warrants as capital property. Prospective purchasers are urged to consult their own tax advisers as to their particular income tax considerations.

Revenue Canada Interpretation Bulletin IT-96R3 provides that:

> "Where an option is issued with another security of the corporation but is severable from it and can be separately traded, the Department (of National Revenue, Taxation) considers that an allocation of the issue price plus any expenses of issue must be made between the option and the security. . . . However, this allocation need not apply where the option is not one of the main reasons for issuing the security and therefore is not of significant value."

On the basis that the Warrants are not one of the main reasons for issuing the Common Shares and therefore are not of significant value, the adjusted cost base of each Warrant would be nil. On this basis the amount of the gain to an initial purchaser of the Warrant would be the total proceeds of sale receivable by that purchaser. If an initial purchaser exercises Warrants and purchases Common Shares of the Company at the exercise price, the adjusted cost base of the Common Shares so acquired would be that exercise price. If an initial purchaser allows a Warrant to expire, there would be no federal Canadian income tax consequences.

DIVIDEND RECORD

During the fiscal year ended October 31, 1979 the Company paid dividends on the outstanding First Preference Shares, Series A at the stipulated annual rate of 7½% per annum and paid a dividend at such rate

on all First Preference Shares, Series A which were redeemed on January 31, 1980. The Company has paid no dividends on its Common Shares. The Company does not intend to pay dividends on its Common Shares and future earnings will be retained to finance further exploration and development. Any decision to pay dividends on the Common Shares in the future will be made by the Board of Directors on the basis of the Company's earnings, financial requirements and other conditions at such time.

TRADING HISTORY OF THE COMMON SHARES

The table below sets forth, for the periods indicated, the reported volume of trading and the high and low sale prices of the Company's Common Shares on The Toronto Stock Exchange and the Alberta Stock Exchange, adjusted to reflect a 3-for-1 split effective September 1, 1978. Since the Common Shares were listed on The Toronto Stock Exchange substantially all trading in Common Shares has been on that Exchange and consequently the share volume on the Alberta Stock Exchange is not shown after June 30, 1978.

	High	Low	Share Volume
	$	$	
1978			
1st Quarter	6.50	4.58	637,830
2nd Quarter (T.S.E. from May 1)	8.38	6.33	863,580
3rd Quarter	8.38	6.75	714,800
4th Quarter	9.00	6.50	852,100
1979			
1st Quarter	9.00	6.75	864,300
2nd Quarter	10.50	7.50	1,203,700
3rd Quarter	16.25	8.63	2,880,700
4th Quarter	17.50	11.13	1,534,762
1980			
1st Quarter	21.88	13.25	3,190,531
2nd Quarter	18.75	13.88	1,635,029
3rd Quarter	19.13	14.25	1,461,446
October	18.50	14.75	912,228
November	18.75	15.50	784,830
December	18.88	15.88	328,509
1981			
January	17.50	15.00	258,706
February 1 to 11	15.50	14.38	112,011

The last sale of Common Shares on The Toronto Stock Exchange on February 11, 1981 was at $14.75.

PLAN OF DISTRIBUTION

Pursuant to an agreement (the "Underwriting Agreement") dated • , 1981 between Merrill Lynch, Royal Securities Limited, as Underwriter, and the Company, the Company has agreed to sell and the Underwriter has agreed to purchase on • , 1981, or on such other date not later than • , 1981 as may be agreed upon, subject to the terms and conditions therein, the Common Shares offered by this prospectus at a price of $ • per Common Share, payable to the Company against delivery of certificates representing the Common Shares. The Company has agreed to pay to the Underwriter, upon the successful completion of this offering, a fee for its services in advising the Company with respect to this offering of $ • (which fee is equivalent to a fee of • % of the proceeds of this offering). The obligations of the Underwriter under the Underwriting Agreement may be terminated at its discretion on the basis of its assessment of the state of the financial markets and may also be terminated upon

the occurrence of certain stated events. The Underwriter is, however, obligated to take up and pay for all of the Common Shares offered by this prospectus if any are purchased under the Underwriting Agreement.

In connection with this offering, the Underwriter may over-allot and effect transactions which stabilize or maintain the market price of the Common Shares at a level above that which might otherwise prevail in the open market. Such transactions may be effected on the Toronto or Alberta Stock Exchanges. Such stabilizing, if commenced, may be discontinued at any time.

MANAGEMENT

Directors and Officers

The names of the directors and officers of the Company, the municipality of residence, the offices held by them in the Company and their principal occupations are as follows:

Name and Address	Office	Principal Occupation
Robert William Lamond* Calgary, Alberta	Chairman of the Board Director	Chairman of the Company
Ian Bell McMurtrie Calgary, Alberta	President Director	President of the Company
Leslie John Broker Houston, Texas	Vice-President Director	Vice-President of the Company
Christopher John Charles Bill* Toronto, Ontario	Director	Vice-President of Merrill Lynch, Royal Securities Limited
Bonita Olivia Rawlyck Calgary, Alberta	Treasurer	Treasurer of the Company
Trevor Llewellyn Clark Williams Calgary, Alberta	Land Manager	Land Manager of the Company
Allan Russell Twa Calgary, Alberta	Secretary	Lawyer with Burnet, Duckworth & Palmer

*Member of the Audit Committee

The Articles of Association of the Company allow for between 3 and 16 members on the Board of Directors until otherwise determined by a general meeting of shareholders. Accordingly, the Board of Directors may appoint directors, in addition to those elected at shareholders' meetings, up to a maximum number of 16 persons.

Mr. Bill has been a Vice-President of Merrill Lynch, Royal Securities Limited since February, 1974. During that period, Merrill Lynch, Royal Securities Limited has entered into two underwriting agreements with the Company as described under "Material Contracts" in addition to the proposed underwriting agreement described under "Plan of Distribution". Mr. Twa has been a lawyer with Burnet, Duckworth & Palmer since 1972. The particulars as to the background and experience of the other directors and officers of the Company and certain of its senior personnel are as follows.

Officers and Senior Personnel of Czar

Robert W. Lamond: Chairman of the Board and Chief Executive Officer, graduated from the University of Edinburgh in 1965 with an Honours degree in Geology. From 1965 to 1969 he held geological positions, first with Imperial Oil Ltd. and then with Mesa Petroleum Ltd. Mr. Lamond was employed by Skye Resources Ltd. from 1969 to 1974, where he held the position of Chief Geologist. Mr. Lamond is the founder of the Company and held the position of President of the Company from its incorporation in 1974 to September, 1980 when he was appointed Chairman of the Board.

Ian B. McMurtrie: President and Chief Operating Officer, graduated in 1970 from Queen's University, Kingston, Ontario with a Bachelor of Science (Honours) degree in Geology and was employed by Texaco Exploration Canada Ltd. from 1970 to 1976 where he was a senior geologist. In 1976 Mr. McMurtrie joined the Company as Chief Geologist and in 1977 he was appointed a Director of the Company and its Exploration Manager. Mr. McMurtrie was appointed Vice-President, Exploration in January, 1980 and President in September, 1980.

Bonita O. Rawlyck: Treasurer and Chief Financial Officer, graduated from the University of Alberta with a Bachelor of Arts degree in 1970. She was admitted to the Canadian Institute of Chartered Accountants in Ontario in 1973 after articling with Thorne Riddell, Chartered Accountants, and continued with Thorne Riddell until 1978. Mrs. Rawlyck joined the Company in 1978 as Controller and was appointed Treasurer in June, 1980.

Anthony D. Convey: Chief Engineer, graduated with a diploma in Petroleum Engineering Technology from the Southern Alberta Institute of Technology in Calgary in 1971. Mr. Convey had been employed for 7 years with respect to the supervision of drilling and completion operations with various companies in western Canada before he joined the Company in 1977 as Drilling Superintendent. In June, 1980 Mr. Convey was appointed Chief Engineer.

Sharon P. Runge: Controller, received the designation Registered Industrial Accountant in 1970 and has gained accounting experience in various oil and gas companies in Calgary since then. She was chief accountant for Siebens Oil and Gas Ltd. prior to joining the Company in 1979. Mrs. Runge was appointed Controller in June, 1980.

Robert H. Johnston: Chief Geologist, graduated from the University of Waterloo in 1974 with a Bachelor of Science in Geology (Honours) and was employed by Chevron Standard Limited in Calgary from 1974 to 1978 as a petroleum geologist. In 1978 he joined the Company as an exploration geologist and was appointed as Chief Geologist in November, 1980.

Trevor L. C. Williams: Land Manager, graduated in 1967 from the University of Calgary with a Bachelor of Arts in Economics. He was employed by Texaco Exploration Canada Ltd. in senior land department positions from 1967 to 1977, held the position of assistant to the Vice-President — Exploration from 1977 to 1979 when he became Manager — Project Planning at Texaco. Mr. Williams joined the Company in 1980.

Officers and Senior Personnel of Czar U.S.

Leslie John Broker: Vice-President, graduated from Michigan Technological University in 1970 with a Bachelor of Science Degree in Geological Engineering. Mr. Broker has been employed as a geologist since 1970: from 1970 to 1973 in western Canada and from 1974 to 1977 with Tesoro Petroleum Corporation in the United States. In 1977 Mr. Broker joined Czar U.S. as Manager of Operations. In 1978 Mr. Broker was appointed a Director of Czar U.S. and in 1980 was appointed as Vice-President and a Director of the Company.

Phillip K. Swyden: Vice-President, Czar U.S. graduated from the University of Oklahoma with a Bachelor of Business Administration in Petroleum Land Management in 1972. He was employed by Continental Oil Company from 1972 to 1976 as a landman. In 1976 he joined Tesoro Petroleum Corporation as District Landman. In 1977 Mr. Swyden joined Czar U.S. as Chief Landman and in October, 1980 was appointed Vice-President of Czar U.S.

J. Michael Gatlin: Chief Engineer, graduated from Mississippi State University in 1969 with a Bachelor of Science Degree in Electrical Engineering. He was employed by Exxon Company U.S.A. as an engineer from 1969 to 1974. In 1974 Mr. Gatlin joined Tesoro Petroleum Corporation as a drilling engineer and in 1978 he joined First Energy Corporation as a petroleum engineer. In 1979 Mr. Gatlin joined Czar U.S. as Chief Engineer.

Peter R. Glidden: Division Geologist, graduated from Lamar University with a Bachelor of Science Degree in Geology in 1970 and graduated from Lehigh University with a Master of Science Degree in Geology in 1972. From 1972 to 1977 Mr. Glidden was employed by Exxon Company U.S.A. In 1977 Mr. Glidden joined Kirby Exploration Company as a geologist for the Gulf Coast Region. In 1979 Mr. Glidden joined Czar U.S. as Division Geologist.

Frederick R. Esch: Coordinator of Financial Planning, graduated from Southern Illinois University with a Bachelor of Science Degree in 1969 and graduated from Arizona State University with a Master's Degree in Business Administration in 1975. In 1976 Mr. Esch became a Certified Public Accountant. Mr. Esch was with the national public accounting firm of Main Hurdman & Cranstoun from 1975 to 1979 in their El Paso and Houston, Texas offices. Mr. Esch joined Czar U.S. in 1979.

Graham B. Livesey: Division Geologist and Manager, of the Denver, Colorado office graduated from University of Exeter, England with a degree of Geology (Honours). Mr. Livesey was employed as a wellsite geologist with Exploration Logging International Incorporated from 1971 to 1973, working in Angola, Gabon, Nigeria and Holland. From 1973 to 1974 he worked with Dresser Industries as a wellsite geologist and engineer in the Gulf Coast area of the United States. From 1974 to 1977 Mr. Livesey was employed as a petroleum geologist with Texaco Exploration Canada Ltd. Mr. Livesey was employed as a geologist in the Calgary office of Czar from 1977 to November, 1980 when he was transferred to the Denver, Colorado office.

Remuneration of Directors and Senior Officers

Remuneration paid by the Company and its subsidiaries in fiscal 1980 to its directors and senior officers was as follows:

	Aggregate Remuneration	
Recipients	Salary and Bonus	Other (2)
	$	$
Directors (One)	—	4,000
Senior Officers (Five)	425,953	119,200

NOTES:

(1) The table states the amounts paid in fiscal 1980 separately for the listed categories of recipients in their respective capacities as senior officers or directors of the Company and its subsidiaries.

(2) The Aggregate Remuneration, Other column includes the spread between the exercise price and the fair market value of any shares purchased under employee stock options and, for senior officers, amounts contributed by the Company to deferred profit sharing plans. The remuneration paid to any of the persons included above does not include any additional value for personal use of Company owned or leased automobiles and club memberships. Although it is difficult to estimate the extent to which these facilities are used for personal purposes, the value thereof is estimated not to exceed $5,000 for any of the persons included above and not to exceed $22,000 for all such persons. See also "Employee Option and Other Plans".

Employee Option and Other Plans

The Company has granted options to purchase Common Shares to certain directors, senior officers and employees of the Company and one other person. The options are exercisable as to one-third each year from either the date of issue or from the first anniversary date of the date of issue on a cumulative basis and expire three or five years following the date of issue. Since October 31, 1980 options have been granted to purchase 18,000 Common Shares exercisable on or before January 19, 1986 at a price of $14.51 per share. Accordingly, as at the present time, there are options outstanding to subscribe for 466,310 Common Shares of the Company. If all such options were exercised, the aggregate consideration to be received by the Company would be $4,567,751. The closing price of the Common Shares on The Toronto Stock Exchange on February 11, 1981 was $14.75 per share. Particulars of all options which were outstanding on October 31, 1980 and which remain outstanding as of the date hereof are set forth in note 3(c) to the Consolidated Financial Statements on page 47.

The various option exercise prices were approximately 10% below the market price on The Toronto Stock Exchange on the date the various options were granted. These optioned Common Shares have not yet been issued.

Since January 1, 1980 Common Shares were issued under various share option agreements to directors, senior officers or other employees of the Company as follows:

	Number of Shares	Price ($)
Directors and Senior Officers	9,900	4.17
	3,300	6.67
	4,000	6.75
	550	9.10
Other Employees	450	3.00
	1,500	6.67
	10,000	7.31
	2,000	7.87
Former Employees	37,110	4.17
	11,000	6.30
	4,000	6.75

An overriding royalty to a maximum of 2.5% of the Company's share of gross production, before deduction of Crown or freehold royalties, from wells drilled after March 30, 1980 has been reserved primarily for the benefit of certain of the professional staff of the Company who are employed at the time of drilling the prospect. The Company had its overriding royalty plan approved at the last annual general meeting of shareholders held March 28, 1980 and paid $4,141 to its senior officers during fiscal 1980. Mr. Lamond does not participate in the plan.

Principal Holders of Shares

The following are the only persons who, to the knowledge of the Company, own beneficially or of record, directly or indirectly, more than 10% of the issued Common Shares of the Company as at the date hereof:

Name and Address	Type of Ownership	Number Shares	% of Class
Robert W. Lamond (1) 2208 Amherst St. S.W. Calgary, Alberta	Beneficial and of Record Beneficial	1,069,000 149,700	12.68
Merrill Lynch, Royal Securities Limited Toronto-Dominion Centre Toronto, Ontario	(2)		

NOTES:

(1) Robert W. Lamond also has an option to purchase 135,000 Common Shares at a price of $4.17 per share exercisable on or before March 7, 1981.

(2) The records of Merrill Lynch, Royal Securities Limited and of Merrill Lynch, Pierce, Fenner & Smith Inc. indicate that they are holding, for the accounts of over 1,500 customers, approximately 985,350 Common Shares (being approximately 10.25% of the Common Shares of the Company). Most, but not all, of these Common Shares are registered in the name of a Merrill Lynch nominee.

The directors and senior officers of the Company, as a group, beneficially own, directly or indirectly, 13.07% of the Common Shares of the Company (• % after giving effect to this offering and to the exercise of the Common Share Purchase Warrants) and after the exercise of options outstanding to such directors and senior officers will own, directly or indirectly, 15.71% of the Common Shares of the Company (• % after giving effect to this offering and to the exercise of the Common Share Purchase Warrants).

Interest of Management and Others in Material Transactions

The following are the only material transactions entered into by the Company during the last three years, or which are presently proposed, in which any of the directors or senior officers or any of their respective associates had or has a material interest.

1. In respect of Canadian activities, certain directors and officers of the Company are the holders of

common shares of Aurora Ltd., or own interests as limited partners in limited partnerships for which Aurora Ltd. is the general partner, or own shares of corporations which are managed by Aurora Ltd. and which limited partnerships or corporations have entered into a joint venture with the Company for the exploration and development of its Canadian properties.

(a) Robert W. Lamond, the Chairman of the Board and a Director of the Company, beneficially owns 68.01% of the issued common shares of Aurora Ltd. and is a Director of Aurora Ltd. Ian B. McMurtrie, the President and a Director of the Company, beneficially owns 4.45% of the issued common shares of Aurora Ltd. Each of the other directors and officers of the Company, except C. J. C. Bill, own shares of Aurora Ltd. In the aggregate, the directors and officers of the Company own 74.9% of the issued common shares of Aurora Ltd.

(b) The directors and officers of the Company have contributed $457,500 to subscribe for limited partnership interests in the various Canadian Aurora limited partnerships. Of this investment and shareholding Robert W. Lamond has contributed $369,050 by way of subscriptions to the Canadian Aurora limited partnerships.

2. In respect of United States activities, Robert W. Lamond is a director of Aurora, Inc. and Rubicon Oil & Gas, Inc., a wholly-owned subsidiary of Rubicon Oil & Gas Ltd., a corporation wholly-owned by Mr. Lamond and members of his family. Rubicon Oil & Gas, Inc. has invested $150,000 U.S. to subscribe for limited partnership units in one United States Aurora Program.

3. Aurora is in the business of raising funds in Canada and the United States through the organization of limited partnerships and public corporations. The limited partnerships or corporations enter into joint venture agreements which provide for the expenditure of monies by the limited partnerships or corporations to earn an interest in prospects of the Company on a joint venture basis. In consideration for acting as general partner and providing management services to the limited partnerships, Aurora receives various interests in revenues generated from the prospects and is reimbursed for its expenses. In the case of Shackleton and Europa, Aurora also provides management services to them, is reimbursed for its out-of-pocket expenses and benefits from holding the gross overriding royalty interest and share options described below. The various interests of Aurora in respect of these partnerships and public corporations are as follows:

Aurora Energy Fund Ltd.	
Aurora 77 Energy Fund	— 5% GORR (1)
Aurora 78 Energy Program	— 5% GORR (1)
Aurora 78-79 Energy Program	— 5% Net Carried Interest (2)
Aurora-Czar 79-80 Energy Program	— 5% Net Carried Interest (2)
Aurora-Venus 79-80 Energy Program	— 5% Net Carried Interest (2)
Aurora-Czar 80-81 Energy Program	— 5/65% of Partnership Interest
Shackleton Petroleum Corporation	— 9.74% of issued shares (3)
Aurora Energy Fund, Inc.	
Czar-Aurora 1979-A, U.S. Ltd.	— (4)
Czar-Aurora 1980 Oil & Gas Drilling Program	— (5)
Europa Petroleum, Inc.	— 10% of issued shares (6)
Shackleton Petroleum Corporation	— (3)

NOTES:

(1) The interest of these limited partnerships in the oil and gas assets acquired pursuant to the joint venture agreement with the Company is subject to a 5% Gross Overriding Royalty.

(2) Aurora Ltd. has earned a 5% net carried interest in the interest of these limited partnerships in their oil and gas assets acquired pursuant to the joint venture agreement with Czar.

(3) Aurora Ltd. has an option to purchase additional shares from the treasury of Shackleton exercisable on or before June 30, 1982 which will, if exercised, increase its percentage interest to 19.61%. In addition, Aurora Ltd. will earn a 5% gross overriding royalty in respect of wells drilled from proceeds of future financing.

(4) Aurora, Inc. pays 1% of all costs and is entitled to a 3% working interest before payout and a 5% working interest after payout.

(5) Aurora, Inc. pays 1% of all costs and is entitled to 1% of revenues. Aurora also earns a 4% net profits interest proportionately reduced by and charged exclusively to the limited partners' account.

(6) Aurora, Inc. will earn a 5% Gross Overriding Royalty in respect of wells drilled from the proceeds of future financing.

At the annual shareholders' meeting of the Company held March 31, 1978, a disinterested majority of the shareholders approved the Company having entered into the joint venture agreements with Aurora 77 Energy Fund and Aurora 78 Energy Program and approved any further agreements for the raising of financing from time to time between Aurora and the Company on the basis that such financing be on terms not less favourable to the Company than those normally obtainable in the industry. Subsequently four other Aurora joint venture agreements were entered into on terms which, in the opinion of management, were not less favourable to the Company than those normally obtainable in the industry. The Company and Czar U.S. have entered into joint venture agreements with Shackleton and Czar U.S. has entered into a joint venture agreement with Europa. The Company's subsidiary, Czar U.S. has entered into two limited partnership agreements dated June 11, 1979 and May 1, 1980 with Aurora, Inc. as co-general partners and United States investors as limited partners. These agreements provide for Czar U.S. to earn an interest in the revenues of the limited partnership as co-general partner and, in the opinion of management, the sharing arrangements as between Czar U.S. and Aurora Inc., are not less favorable to Czar U.S. than those normally obtainable in the industry and represent fair compensation to Aurora Inc. for the services which it performs in connection with administering the affairs of those partnerships.

4. As indicated under "Proposed Reorganization of Certain Canadian Aurora Programs", the Company proposes to enter into a joint venture agreement with ACE which will acquire substantially all the oil and gas property interests held by four of the Canadian Aurora Programs and may raise a maximum of $40,000,000 from the public in Canada. Robert W. Lamond, Ian B. McMurtrie and C. J. C. Bill, directors of the Company, are to be directors of ACE. Mr. Bill is to receive an option from ACE entitling him to acquire 20,000 common shares of ACE at $5.00 per share, such option being exercisable over a period of 5 years, as to 50% at any time on or after January 1, 1982 and as to the balance, on a cumulative basis, at any time on or after January 1, 1984. The option is conditional upon Mr. Bill remaining a director of ACE until the date of exercise of the option. A joint venture agreement is proposed to be entered into between the Company, Aurora and ACE. The joint venture agreement will deal with operations on properties transferred from the four Canadian Aurora Programs and also with operations on properties acquired thereafter. With respect to properties acquired from the Canadian Aurora Programs the Company and Aurora will have the same interests as they had in the operation of those properties prior to their transfer to ACE. With respect to new prospects the Company will have a 19% carried interest on all costs other than operating costs and Aurora will have a 3% carried interest on all costs other than operating costs.

5. Aurora 77 Energy Fund was formed on September 30, 1977. The Aurora 77 Energy Fund entered into a joint venture agreement dated September 1, 1977 with Czar pursuant to which certain Canadian properties of Czar were explored and developed. On November 30, 1979 Aurora 77 Energy Fund assigned to the Company its interest in certain oil and gas properties in the Birch area of British Columbia in consideration for $2,000,000, pursuant to a right of first refusal contained in the joint venture agreement. The Company had this agreement ratified at the special and annual general meeting held March 28, 1980. On January 1, 1980 Aurora 77 Energy Fund sold an interest in all of its assets to the Company for $793,472 in order to finance the retirement of units tendered by limited partners pursuant to an offer made by the limited partnership pursuant to the applicable limited partnership agreement.

6. The Company has entered into several drilling program agreements providing for the disposition and exploration of oil and gas prospects of the Company on a joint venture basis. Copetrex is the general partner of the limited partnerships formed pursuant to the laws of Alberta with which the Company has entered into the drilling program agreements. Robert W. Lamond was a director of Copetrex from October 28, 1977 to June 29, 1978 during which time the Company entered into the drilling program agreement with Copetrex dated April 7, 1978. Mr. Lamond was nominated to the Copetrex board to satisfy the Alberta residency requirements for directors pursuant to The Companies Act (Alberta) and did not have and does not have any financial interest in Copetrex. Reference is made to "Drilling Programs — Copetrex".

Reference is made to "Drilling Programs" and to "Directors and Officers" for the municipality of residence of each of the individuals named above and to "Material Contracts" for information as to the availability of copies of such agreements.

Conflicts of Interest

Robert W. Lamond, as a principal shareholder, and Ian B. McMurtrie, as a shareholder, have various interests in a number of public and private companies carrying on business in the oil and gas industry, principally in western Canada. It is possible that, in the ordinary course of the business of Czar and in the ordinary course of the business of these other public and private companies, circumstances will arise where prospects may be offered to Czar and to one or more of these other companies by third parties. It is also possible from time to time that properties may be offered to Czar from one or more of those other oil and gas companies in which directors or officers of Czar have an interest. Thirdly, it is to be expected that properties acquired by Czar will be offered in whole or in part from time to time to one or more of the various drilling funds or other programs sponsored by Czar or may in fact be purchased by Czar from one or more of those funds or programs.

These various potential conflicts of interest will be dealt with in various ways. Transactions to be entered into by Czar in which directors or officers of Czar have a material interest must be approved in accordance with the provisions of Alberta law which, in effect, require the transaction in question to be approved either by a disinterested quorum of directors of Czar or by the approval of a majority of the votes cast at a general meeting of shareholders of Czar called for that purpose. In addition, Alberta law provides that the directors and officers of Czar have a fiduciary duty to and must act in the best interests of Czar. The Canadian Aurora Agreements contemplate that interests in prospects which are offered to the Aurora limited partnerships will be offered at the lower of cost or fair market value. Accordingly, under these agreements, Czar may be obliged to dispose of interests in properties below their fair market value where cost is less than fair market value. The various Aurora Agreements have been approved both retroactively and prospectively by the requisite majority of shareholders of Czar, all as required under Alberta law.

It is also possible that Mr. Lamond may directly, or through Aurora (which he controls), assist in raising financing for one or more of these various public or private companies and that the raising of such financing may reduce the amount of financing which might otherwise be available for the Company.

THE NATIONAL ENERGY PROGRAM

The federal government tabled on October 28, 1980 its proposed National Energy Program for Canada which included the following significant matters:

1. The federal government proposes an excise tax on all sales of natural gas and gas liquids. The tax, which is paid by the consumer, commenced November 1, 1980 on domestic sales and will begin February 1, 1981 on export sales. Such excise tax is initially to be 30¢ per Mcf of gas and will increase to 75¢ per Mcf of gas by January 1, 1983.

2. The federal government proposes a tax of 8% of net operating revenues relating to the production of oil, gas and natural gas liquids on the producer.

3. The federal government proposes to set the price for oil and gas in the inter-provincial and export market without agreement of the producing provinces. The current average wellhead price of Canadian conventional crude oil is set at $17.75 per barrel; increasing $1.00 per barrel semi-annually commencing on July 1, 1981 until the end of 1983. This price is substantially less than the current world price for oil.

4. Under the proposed National Energy Program the increases in the price of natural gas will be deferred by 13 months from the date of the corresponding oil price increases.

5. The proposed National Energy Program includes a Petroleum Incentives Program pursuant to which certain grants will be payable to persons incurring exploration and development costs approximating those outlined in the Income Tax Act (Canada) for "Canadian exploration expenses" and "Canadian development expenses". For companies which have Canadian ownership of at least 75% and are Canadian controlled, grants are payable as to 35% of such Canadian exploration expenses and as to 20% of such Canadian development expenses. Lesser grants are available for companies that are Canadian controlled and that have Canadian ownership of between 50% and 75%. It is unclear how a public corporation will ascertain its degree of Canadian ownership and control. See "Petroleum Incentives Program".

It is, of course, open to the federal government to amend all or any of these proposals. In response to these proposals, the province of Alberta recently passed regulations which will allow the reduction of deliveries of crude oil from Alberta Crown petroleum and natural gas leases in the amount of 60,000 barrels per day on each of March 1, 1981, June 1, 1981 and September 1, 1981. Such reduction if fully implemented will reduce current Alberta crude oil production by 15%.

Position of the Company

The Company has analyzed the uncertainties to be encountered during 1981 in the oil and gas industry. The Company believes that the following factors are material in considering the impact which these uncertainties will have on the Company:

1. The Company has completed studies as to the present worth of its oil and gas revenues based on the proposals put forth in the proposed National Energy Program and has nevertheless established an increase in the present value of estimated future net revenue from its reserves as of October 31, 1980 of 41% from the present value thereof, discounted at 15%, as of October 31, 1979. See "Reserves".

2. The Company enjoys in excess of 31% of its present cash flow from production from oil and gas properties located in the United States. The Company established an office in the United States in 1977 and has increased its activities to the extent that during the 1981 fiscal year it expects to have 50% of its total exploration and development activities centered in the United States. This constitutes an increase from approximately 20% to 50% in activity in the United States from the 1980 fiscal year.

3. The Company has recently entered into an agreement with CGSL and Sherritt to sell to CGSL for delivery to Sherritt natural gas in order to supply the volumes of natural gas required by Sherritt for its planned ammonia manufacturing operation in Fort Saskatchewan, Alberta which is to be completed in 1983. In the meantime, the Company and its joint venture participants have entered into interim gas field purchase contracts for the sale of up to 5 Mmcf per day until February 1, 1983 at a price which is approximately 70% of the average field price for natural gas plus 100% of the gas export rebate. As of February 1, 1983 the quantities of gas to be sold to Sherritt will increase to 28 Mmcf per day for the period February 1, 1983 to October 31, 1984 and to 30 Mmcf per day for the period from November 1, 1984 to October 1, 1995 at prices which constitute a higher percentage of the average field price for natural gas. See "Sale of Production".

4. The Company is in the process of ascertaining whether it will have the requisite 75% Canadian ownership and control in order to qualify for the maximum proposed petroleum incentive grants. The Company is presently Canadian controlled. While it is not entirely clear, the Company believes that it has a Canadian ownership rating in excess of 65% and may after this issue have a Canadian ownership rating of at least 75%. See "Petroleum Incentives Program".

5. The decision by the Alberta government to cut back the export of oil by approximately 15% will not effect a significant decrease in the Company's revenues (about $100,000 in fiscal 1981 before income taxes).

RISK FACTORS AND INDUSTRY CONDITIONS

Risk Factors

Oil and gas exploration involves many risks which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that further commercial quantities of oil and gas will be discovered by the Company. The marketability of oil and gas acquired or discovered by the Company will be affected by numerous factors beyond the control of the Company. These factors include market fluctuations, the proximity and capacity of oil and gas pipelines and processing equipment and government regulation (including regulations relating to royalties, allowable production, importing and exporting of oil and gas and environmental protection). In addition, at the present time there is a surplus of producible natural gas reserves in Alberta and British Columbia as compared to current Canadian demand for natural gas. There is no assurance that the Canadian government will allow all or any part of this surplus to be exported to meet international demand. The exact effect of these factors cannot be accurately predicted but the combination of these factors may result in the Company not receiving any return on the Company's invested capital.

The oil and gas industry is intensely competitive in all phases. The Company, as an independent oil and gas exploration company, faces competition from other independent oil and gas exploration companies, individuals and major oil companies engaged in the acquisition, exploration, development and production of hydrocarbon substances in all areas in which the Company operates or proposes to operate. There is a high degree of competition for petroleum and natural gas lands which are favorably situated and prospectively desirable for exploratory operations. Many of the companies and individuals so engaged possess financial resources and technical facilities greater than those available to the Company and may therefore, among other things, be able to pay greater sums for desirable lands or to define more potentially productive prospects than the Company's financial or technical resources permit. There is also a high degree of competition for the relatively scarce services of the skilled personnel needed by the industry. The Company anticipates that competition may be expected to increase in view of the present worldwide demand for crude oil and natural gas.

The Company's oil and gas exploration operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering and oil spills, each of which could result in substantial damage to oil and gas wells, producing facilities, other property and the environment or in personal injury. Although the Company maintains liability insurance in an amount which it considers adequate, the nature of these risks is such that liabilities could exceed policy limits, in which event the Company could incur significant costs that could have a materially adverse effect upon its financial condition.

Another risk of the Company's operations is the necessity of incurring large expenditures for locating and acquiring properties, drilling exploratory wells and developing properties. In conducting its exploratory activities, the Company engages in programs which might be expected to provide substantial reserves in the event of a discovery but which may involve a relatively large investment and a high likelihood of failure. No assurance can be given that oil or gas will be discovered to replace reserves currently being developed, produced and sold, or that if oil or gas is found, it will be present in sufficient quantities to enable the Company to recover costs incurred in its discovery.

The ability of the Company to raise funds through the drilling programs is, to a large degree, the result of tax incentives provided by the relevant laws. There is no assurance that these incentives will not be changed adversely. Elimination of tax incentives would not detrimentally affect the value of the Company's proven and probable reserves of oil and natural gas but would substantially curtail the speed with which the Company is able to expand. The Company's expansion would then be financed through bank borrowings, equity financing and such other financing methods as would then be appropriate.

A further risk of participation in the oil and gas industry in Canada relates to the degree to which the activities of the industry are regulated by the provincial governments and by the Canadian federal government. By virtue of the regulation of the industry by these levels of government it is uncertain whether, if oil and natural gas are located by the Company, the Company will be allowed to produce that oil and natural gas and, if the Company is allowed to do so, the price at which it is allowed to sell its product, whether domestically or on the export market, is subject to restraints under relevant government legislation. There is presently no assurance that the effect of such government restraints upon price, when combined with provincial and federal taxation, will allow the Company to realize a net profit after tax from the production of oil and natural gas.

As is common industry practice, little or no investigation of title is made at the time of acquisition of undeveloped properties, other than a preliminary review of local mineral records. Title investigations are made, in most cases by obtaining a title opinion of local counsel, before commencement of drilling operations. The Company believes that it generally has satisfactory title to its gas and oil properties. In Canada, such properties are subject to customary Crown interests, and all of its properties are generally subject to other royalty interests contracted in connection with the acquisition of the properties, liens incident to operating agreements, liens for current taxes and other burdens and minor encumbrances, easements and restrictions. The Company believes that none of such burdens materially detracts from the value of such properties or from the Company's interests therein or materially interferes with their use in the operation of the Company's business. Approximately 20% of the Company's properties are also pledged to secure bank borrowings.

Regulation

Canadian Regulation

The petroleum industry in Canada operates under federal, provincial and municipal legislation and regulations covering land tenure, royalties, production rates, pricing, environmental protection, exports and other matters. Under the British North America Act (1867) the federal government has jurisdiction over inter-provincial and international trade, whereas the provincial governments have jurisdiction over production of natural resources.

Recent conflicts between the federal government and various provincial governments with respect to jurisdiction over natural resources have created uncertainty as to future legislative conditions. Outlined below are some of the more significant aspects of governmental legislation and regulations which will affect the Company's operations.

Land Tenure

On December 9, 1980 the Canada Oil & Gas Act was given first reading in the House of Commons as Bill C-48. The Canada Oil & Gas Act, if enacted, will set forth new requirements for the holding, exploration and development of Canada lands (federal lands located in the Yukon and Northwest Territories and offshore Canada). The Canada Oil & Gas Act in part is designed to implement the federal government's proposed National Energy Program.

The majority of mineral rights in Alberta and British Columbia are owned by the Crown in right of the Province and a small percentage is held by freehold mineral owners. The governments of each of these provinces have enacted regulations respecting the rights of individuals, corporations and partnerships to explore for, drill and produce oil and natural gas on Crown lands.

All Alberta Crown petroleum and natural gas leases issued after July 1, 1976 have an initial term of five years, which term may be continued by production or deemed production in respect of all or part of the lands and formations included in such leases which are capable of commercial production. The rights to drill below the base of producing zones which are incapable of commercial production will revert to the province at the end of the primary term of the lease. The right to explore for petroleum and natural gas in the province of Alberta may be acquired through exploratory licences or leases, for terms varying from two to five years, depending on the location of the land. Upon completion of certain drilling requirements, the holder of the licence is entitled to a lease of such lands. The holder of the lease is then permitted to produce from a well or wells drilled thereon under the terms and conditions of such lease.

Alberta Crown royalties on crude oil vary with the volume and price of monthly production of oil, up to 36% for new oil and up to 50% for old oil. The term "new oil" refers to oil obtained from certain exploratory wells licenced on or after April 1, 1974 and additional oil obtained as a result of enhanced recovery schemes approved on or after April 1, 1974. The royalty rate in Alberta for natural gas also varies with the monthly volume from the well and the selling price of natural gas sold in the province, such royalty rates varying up to 33% for new gas and up to 46% for old gas. The term "new gas" refers to natural gas discovered after January 1, 1974 or obtained from a pool not produced prior to January 1, 1974.

British Columbia Crown royalties on crude oil also vary with the volume of monthly production, and range from nil to approximately 30% for new oil and from nil to 40% for old oil. "New oil" is oil produced from a well drawing from a pool not containing a well completed prior to November 1, 1975 or from a pool not defined on November 1, 1975. In British Columbia, virtually all gas is purchased by the British Columbia Petroleum Corporation at a price substantially below the market value for natural gas, and such gas is exempt from Crown royalties.

Provincial Incentives

The province of Alberta has enacted Exploratory Drilling Incentive Regulations which provide for credits applicable to certain wells commenced prior to April 1, 1981. When a certified exploratory well on Crown lands, with the exception of most wells less than 2,000 feet in depth, results in an oil or gas discovery, no royalty is payable from the commencement date of the production for a period of five years in the case of oil

and for a period of one year in the case of natural gas. In addition, credits may be earned through participation in eligible seismic and geophysical surveys pursuant to the Geophysical Incentive Program Regulations.

The Province of British Columbia has to date enacted no incentive programs.

Oil and Gas Pricing

Under the Petroleum Administration Act (Canada), the federal government can regulate the price of oil and gas in international and inter-provincial trade, either with or without provincial agreement. However, the pricing of oil and gas which is consumed outside of the province of its production has been determined from time to time by agreement between the federal government and the producing provinces. These pricing agreements established a two price system for oil and gas: the lesser price being the domestic price for oil and gas consumed in Canada, and the higher price being an export price for oil and gas exported from Canada. The most recent of these agreements with respect to the pricing of crude oil expired July 31, 1980, prior to which the federal government and the producing provinces had attempted unsuccessfully to reach a new agreement. The governments of Alberta and Saskatchewan acted unilaterally to increase the price of crude oil by $2.00 per barrel effective August 1, 1980.

The federal government under its proposed National Energy Program ("NEP"), proposes to set all future increases in the price of oil. The price of Canadian crude oil will be based on the weighted average cost of imported oil and various streams of domestic oil, referred to as the "blended price". This "blended price" will not be allowed to exceed 85% of the international price or the average price of oil in the United States, whichever is lower. The wellhead price of conventional oil increased $1.00 per barrel to $17.75 on January 1, 1981 and will rise a further $1.00 every 6 months until December 31, 1983. Thereafter, until December 31, 1985, the NEP proposes that the price increases will take place at the rate of $2.25 every 6 months. Commencing in 1986 the price will rise at the rate of $3.50 every 6 months until it reaches its appropriate quality-determined level relative to the oil sands. If by 1990 the conventional oil price is still below a "reference price", consideration will be given to a more rapid rate of escalation. The "reference price" will be the lesser of $38.00 per barrel, effective January 1, 1981 and escalated annually thereafter by the Consumer Price Index, and the international price.

Significant amounts of Alberta and Saskatchewan heavy crude oil are exported to the United States. Although the export price of such oil is substantially greater than the domestic price, the wellhead price received by the producer for exported oil is identical to that received for domestic oil. The difference consists largely of the export tariff which flows directly to the federal government. Under the NEP, the federal government proposes that as of November 1, 1980, 50% of the export tariff revenue be shared with the provinces of Alberta and Saskatchewan.

Prior to November 1, 1980, the price for natural gas established under the Petroleum Administration Act (Canada), known as the Toronto City Gate Price, was fixed at approximately 85% of the cost of oil in the Toronto area on an energy equivalent value. Through the various federal-provincial pricing agreements, the latest of which was extended to October 31, 1980, domestic gas prices have been increased in several stages to the current price of approximately $2.60 per Mcf at the Toronto City Gate. In determining the average field price to the Alberta producer, one must subtract the cost of transportation to Toronto and the Alberta cost of service.

Under the NEP, the federal government, as of November 1, 1980, established common city-gate prices for natural gas shipped inter-provincially in all centres east of Alberta. The price of natural gas will, except during the calendar year of 1981, continue to rise $0.15 per Mcf for every $1.00 increase in the wellhead price of conventional crude oil. Within British Columbia and Alberta, the price of gas produced and consumed within the province will continue to be set by their respective provincial governments.

Approximately one-third of Alberta's natural gas production is currently exported to the United States. The price of natural gas exported to the United States as of February 5, 1981 is $4.75 U.S. per Mcf, which price was set by the National Energy Board. The additional revenues generated from the excess of the export price over the domestic price are paid into Alberta's Natural Gas Pricing Agreement Act Fund, from which these revenues are then distributed as a price adjustment to all gas producers pro-rata according to their individual shares of Alberta production. As of November 1, 1980, the average sale price for gas removed from Alberta, including the price adjustment, was approximately $2.49 per Mcf.

The price of natural gas in British Columbia is determined on a different basis from that in Alberta. The prevailing price is set by the British Columbia Petroleum Corporation, which is the purchaser of virtually all gas produced within British Columbia. Currently, producers of "new gas" are receiving approximately $1.38 per Mcf and producers of "old gas" are receiving approximately $1.13 per Mcf. Hearings to consider changes in the administration of gas pricing in British Columbia were held in 1980 and further hearings are anticipated for 1981.

All natural gas sales (including sales of liquified petroleum gas) in the domestic and export markets are, pursuant to the NEP, to be subject to a tax of $0.30 per Mcf commencing November 1, 1980 which will increase by $0.15 per Mcf on July 1, 1981, January 1, 1982, and January 1, 1983. This tax is added to the domestic price of natural gas and is therefore borne by the consumer. As a result of the Canada-United States agreements and gas export market conditions, the federal government has determined that the natural gas tax shall not be added to the export price of natural gas at this time. The impact of this tax on export of gas to the United States is uncertain at this time; any reductions in exports will likely reduce the monthly export adjustment currently received by Alberta producers.

Oil and Gas Production

The federal government, through the NEB, regulates the volumes of oil and gas exported from Canada. Because of a concern for Canada's energy self-sufficiency, the NEB instituted a policy in 1974 reducing permissible exports of light and medium gravity crude oil on a gradual basis with a view to phasing out such exports by the end of 1981. The present policy of the NEB is to permit exports of natural gas from Canada which are surplus to Canadian requirements as determined by the present protection formula of the NEB.

Generally, the provinces also have statutory provisions regulating the production of crude oil and natural gas. The regulations, among other things, require drilling permits, set well spacing, prevent the wasting of oil and gas resources, and control the rate of production. The provinces regulate the amount of oil and gas produced locally by assigning to each well or proration unit an allowable rate of production.

The production of crude oil from wells in western Canada is regulated by various agencies. Effective April 1, 1980 the Alberta Petroleum Marketing Commission became the exclusive marketer of all oil produced from Crown lands in the province. Under recently enacted amendments to The Mines and Minerals Act (Alberta), the Lieutenant Governor in Council may, if he considers it to be in the public interest to do so, make regulations fixing the maximum amount of petroleum that may be produced under Alberta Crown leases during any month. As a result of the Alberta and federal governments being unable to reach an agreement with respect to the price of crude oil, and the imposition by the federal government of the NEP without the agreement of the Alberta government, the government of Alberta has announced it will cut back oil production until an agreement is reached. The proposed cutbacks of production are to be 60,000 barrels per day as of March 1, June 1 and September 1, 1981, to a maximum of 180,000 barrels per day. The proposed reduction is subject to abatement in the event of a national emergency or a resolution of the dispute between the federal government and the province of Alberta as to the pricing of energy.

On December 6, 1979, the federal government announced that it would allow an increase in gas exports of up to 3.75 trillion cubic feet of natural gas over the next eight years. The NEB has recently approved an additional short-term export of 0.5 trillion cubic feet of natural gas. However, with respect to the consideration of future natural gas applications, the NEB has been asked by the federal government, pursuant to the proposals of the NEP, to take into account the level of Canadian ownership of the applicant, giving preference to Canadian owned and Canadian controlled firms. The NEB has indicated that it will consider applications for additional short-term exports which are designed to finance the pre-build portion of the proposed northern pipeline. Owing to the short-term nature of the newly authorized natural gas exports, the slow growth of the Canadian natural gas markets and the uncertainty of whether the purchasers of the natural gas authorized for export to the United States can obtain the necessary United States import approvals for such natural gas, there has been a general reluctance of the major exporters of natural gas to enter into long-term firm take-or-pay contracts with natural gas producers in Alberta. There is no assurance that future discoveries of natural gas in commercial quantities will be marketable.

Petroleum and Gas Revenue Tax

The NEP proposed a new Petroleum and Gas Revenue Tax. The Minister of Finance, Allan MacEachen, introduced draft legislation with respect to this new tax in the House of Commons on December 17, 1980 (the "draft legislation").

Part I of the draft legislation imposes an 8% tax commencing January 1, 1981 on the production revenue of every person. Production revenue is the net income from the production of petroleum or gas, or the processing in Canada of petroleum to any stage that is not beyond the stage of crude oil or its equivalent computed in accordance with the Income Tax Act (Canada) except that no deduction will be allowed for certain amounts including depletion, depreciation, exploration or development expenses, interest or other financial expenses, inventory and resource allowances, research expenses, and government royalties, taxes, lease rentals, or bonus payments with respect to the production of petroleum or gas.

Part II imposes a tax of 8% on resource royalties received by any person. A resource royalty is an amount computed by reference to the amount or value of production after December 31, 1980 of petroleum and gas. The person who pays a resource royalty is required to withhold the amount of this tax and remit that amount to the Receiver General for Canada.

The tax imposed by the draft legislation is not deductible in computing the income of a taxpayer under the Income Tax Act (Canada).

Petroleum Incentives Program

The NEP proposed that a new system of direct incentive payments be introduced and on December 19, 1980, the Department of Energy, Mines and Resources (Canada) released a document entitled "Petroleum Incentives Program — The Basic Rules — A Framework". This document proposes a method of determining the amount of incentive payments that will be made as a result of the proposed NEP. The level of incentive payments varies depending on the level of Canadian ownership and whether or not an applicant is Canadian controlled. On November 21, 1980 the Petroleum Monitoring Agency released a document entitled "Measurement and Determination for Canadian Ownership and Control". This document proposes a method of determining an applicant's Canadian ownership rate and whether or not the applicant is Canadian controlled. The Canadian ownership rate of a corporation is determined by reference to the beneficial ownership of the shares of that corporation.

A corporation that has a Canadian ownership rate of at least 75% and is Canadian controlled is entitled to incentive payments at the rate of: 80% of eligible exploration expenses incurred on Canada lands; 35% of eligible exploration expenses incurred on provincial lands; and 20% of eligible development expenses. These incentive payments will be made commencing in 1981. A corporation that has a Canadian ownership rate of between 50% and 75% is entitled to incentive payments at the rate of: 35% in 1981 increasing to 50% in 1984 of eligible exploration expenses incurred on Canada lands; 10% in 1982 increasing to 15% in 1984 of eligible exploration expenses incurred on provincial lands; and 10% in 1981 and thereafter of eligible development expenditures. In a case where these expenses are incurred on lands held by the applicant, the eligible expenses will be proportionately reduced if the costs borne by the applicant are in excess of its working interest in such lands. In a case where the applicant is incurring these expenses in order to earn a working interest, the eligible expenses will be proportionately reduced if the costs incurred by the applicant are more than double the working interest earned by the applicant in such lands.

At the present time taxpayers are entitled to claim a depletion allowance which is generally equal to one-third of oil and gas exploration expenditures, development expenditures and certain capital expenditures. A taxpayer will not be entitled to claim this depletion allowance for expenditures on conventional oil and gas development after January 1, 1981. Domestic exploration expenditures outside the Canada lands by corporations will be entitled to a depletion allowance at a declining rate as follows: one-third in 1981; one-fifth in 1982, one-tenth in 1983 and thereafter no depletion allowance will be available for such expenditures.

Natural Gas Bank

The NEP proposes to establish a gas bank for the purpose of purchasing natural gas from Canadian

owned and Canadian controlled firms who are unable to find markets, and to enter into joint venture operations with such firms or to provide production loans to them.

Provincial Response to the NEP

As a result of the introduction by the federal government of the NEP, the Alberta government, in addition to its announcement of the cutbacks in production of conventional oil, has frozen approval of future oil sands and tertiary production projects. Further, the governments of the provinces of Alberta and British Columbia have announced their intention to challenge the natural gas excise tax imposed by the federal government under the provisions of the NEP. The controversies in federal-provincial relations created by the introduction of the NEP will, until their resolution, make it impossible to predict with any certainty the full impact of the NEP on the petroleum industry.

United States Regulation

General

The oil and gas industry in the United States is subject to extensive federal and state regulations governing both the conduct of operations and the marketing of hydrocarbons once production is established. Matters which are subject to federal or state control include permits to drill, the location of wells, measures required for protection of the environment, limitations on production for conservation, and enforced relationships between such producers of crude oil and their purchasers and between producers of certain natural gas sold in interstate and intrastate commerce for resale and their purchasers. Moreover, the Company's operations may be affected from time to time in varying degrees by changes in federal and state laws and regulations.

Numerous proposals have been and are being introduced in Congress which could materially affect the Company's oil and gas operations in the United States. The economics of oil and gas exploration and development are particularly sensitive to changes in tax laws and administrative regulations relating to the petroleum industry. In addition, oil and gas operations are subject to interruption or termination by governmental authorities on account of ecological and other considerations.

Oil Price Controls

Until January 28, 1981, crude oil production in the United States was subject to federal price and allocation controls. On that date, President Reagan signed an Executive Order removing those controls, effective immediately. Certain categories of production established under the system of price controls remain effective, but only for purposes of calculating the amount of Windfall Profit Tax due upon the sale of United States domestic crude oil.

Windfall Profit Tax

The Crude Oil Windfall Profit Tax Act of 1980 (the "Act") enacted an excise tax on the additional revenues from sales of oil production received as a result of oil price decontrol. The Act provides for the following:

(1) Oil classified as "upper tier" (in general oil discovered and produced after May, 1973 but before June, 1979) and "lower tier" (which generally is oil discovered and produced before June, 1973) for price control purposes prior to decontrol is subject to tax as "tier 1 oil". The tax is 70% of the excess (less an adjustment for certain state severance taxes paid allocable to this excess) of (i) the removal price (generally the sales price) of the oil over (ii) a base price originally averaging $13.20 U.S. per barrel, with grade, quality and locational differences. The base price is subject to adjustment for future inflation.

(2) Stripper oil (crude oil from wells which produced an average of 10 barrels or less during a 12 month qualifying period) is subject to tax as "tier 2 oil". The tax is 60% of the excess (less an adjustment for certain state severance taxes paid allocable to this excess) of (i) the removal price over (ii) a base price originally averaging $15.20 U.S. per barrel, with grade, quality and locational differences. The base price is subject to adjustment for future inflation.

(3) Newly-discovered oil, incremental tertiary oil and heavy oil are subject to tax as "tier 3 oil". The tax is 30% of the excess (less an adjustment for certain state severance taxes paid allocable to this excess) of (i) the removal price over (ii) a base price originally averaging $16.55 U.S. per barrel, with grade, quality and locational differences. The base price is subject to adjustment for future inflation, plus an additional ½% per quarter "kicker".

(4) The taxable "windfall profit" on a barrel of oil is limited to 90% of the net income attributable to that barrel of oil.

(5) Special treatment has been accorded to sales of certain categories of oil by "independent producers". Reduced tax rates apply to the first 1,000 barrels per day of an independent producer's combined production of oil subject to the tax on tier 1 oil and tier 2 oil. The reduced tax rate is 50% in the case of tier 1 oil and 30% in the case of tier 2 oil. Most royalty owners do not qualify for reduced tax benefits under the independent producer provisions.

(6) The Windfall Profit Tax paid is deductible from income for federal income tax purposes. However, the tax base for Windfall Profit Tax purposes is not required to be excluded from gross income for purposes of calculating percentage depletion. The deduction for the Windfall Profit Tax will have to be taken into account in computing the 50% of net income and 65% of taxable income limitations on the percentage depletion deductions.

It is anticipated that substantially all of the Company's future United States crude oil production will qualify for pricing and Windfall Profit Tax treatment as newly discovered oil or upper tier oil.

Gas Price Controls

The Natural Gas Policy Act of 1978 ("NGPA") came into force on November 9, 1978. The NGPA substantially altered the pre-existing system of federal price regulation over sales of natural gas. The NGPA establishes a comprehensive set of statutory ceiling prices applicable to all first sales of natural gas. This system provides differing ceiling prices for specific categories of natural gas production. Taken together these categories cover the entirety of domestic natural gas production. A significant departure of the NGPA from historical federal price regulation over sales of natural gas is that the ceiling prices established under the NGPA apply to sales of natural gas in intrastate commerce as well as to sales of natural gas in interstate commerce.

Administration and enforcement of the NGPA ceiling prices have been delegated to the Federal Energy Regulatory Commission ("FERC"), an independent commission established within the DOE. The manner in which the FERC implements and enforces the provisions of the NGPA may affect the extent to which the NGPA affects the operations of the Company.

New natural gas is defined by the NGPA to include natural gas produced from: (1) certain new leases on the Outer Continental Shelf; (2) certain new onshore wells; and (3) certain new onshore reservoirs.

The NGPA ceiling price for new natural gas was initially established as of April, 1977 at $1.75 U.S. per Mmbtu. This ceiling price for new natural gas increases monthly by an amount equal to the rate of inflation, as measured by the adjusted GNP implicit price deflator, plus a growth factor equal to 3.5% prior to May, 1981 and 4.0% thereafter.

New onshore production wells are defined as wells drilled on or after February 19, 1977, which satisfy applicable well-spacing requirements and are not drilled within an existing proration unit. The NGPA ceiling price for gas produced from a new onshore production well was initially established at $1.75 U.S. per Mmbtu as of April, 1977. This ceiling price increases monthly by an amount equal to the rate of inflation as measured by the adjusted GNP implicit price deflator.

Under the NGPA, unless a higher price is applicable, natural gas dedicated to interstate commerce prior to enactment of the NGPA is subject to price controls based upon the system of just and reasonable prices established by the FERC under the Natural Gas Act. However, more rapid price increases are provided under the NGPA than were provided under the Natural Gas Act.

The NGPA established ceiling prices for gas sold under existing intrastate contracts based upon the price terms of the contract in effect on the date of enactment of the NGPA. Contractually authorized price

escalations may operate to increase the price under an existing intrastate contract up to the level of the new gas ceiling price (and, in some cases, higher).

Special prices are authorized under the NGPA for high cost gas and gas produced from stripper wells, i.e., wells which produce less than 60 Mcf per day during the ninety-day qualifying production period. The ceiling price for stripper well gas was established as $2.09 U.S. per Mmbtu as of May, 1978, with price increases authorized at the same rate as for new natural gas. Statutorily defined categories of high-cost gas including that produced from new wells completed at a depth of more than 15,000 feet is exempt from any federal ceiling price. The FERC has initiated administrative actions to establish incentive prices for other categories of high-cost gas, e.g., gas from tight formations.

The NGPA provides for removal of price controls over certain categories of natural gas production at certain specified dates. Thus, certain high-cost gas has been deregulated effective November 1, 1979. Additionally, three categories of natural gas production will be deregulated from NGPA ceiling prices on January 1, 1985:

(1) new natural gas;

(2) natural gas subject to an existing intrastate contract as of the date of enactment of the NGPA and for which the price on December 31, 1984 is higher than $1.00 U.S. per Mmbtu; and

(3) natural gas produced through a new onshore production well if the gas was not committed or dedicated to interstate commerce on or before April 20, 1977 and is produced from a completion location more than 5,000 feet deep.

Natural gas produced through a new onshore production well will be deregulated from NGPA ceiling prices on July 1, 1987, if the gas was not committed or dedicated to interstate commerce on or before April 20, 1977, and is produced from a completion location 5,000 or less feet deep. All other categories of natural gas production remain under NGPA ceiling price controls indefinitely. With respect to deregulation of categories of natural gas other than high-cost gas, the NGPA ceiling prices are subject to temporary reimposition for a single 18 month period. The President may temporarily reimpose controls at any time after June 30, 1985 and prior to July 1, 1987.

It is anticipated that most of the Company's future United States natural gas production will qualify for pricing treatment as new natural gas or as gas produced from new onshore production wells.

Environmental Regulations

The federal government and various state governments have adopted laws and regulations regarding the control of contamination of the environment. These laws and regulations may require the acquisition of a permit before drilling commences, prohibit drilling activities on certain lands lying within wilderness areas or where pollution arises and impose substantial liabilities for pollution resulting from drilling operations, particularly operations in offshore waters or on submerged lands.

Violation of environmental legislation and regulations may result in the imposition of fines and, in certain circumstances, the entry of an order for the abatement of the conditions, or suspension of the activities, giving rise to the violation.

Proposed Legislation

A number of bills were introduced during the last session of Congress which, if re-introduced during the present session of Congress and enacted, could have a significant impact upon the petroleum industry. The various bills and proposals involve, among other matters, the creation of a federal oil and gas company to compete with private industry and divestiture of various sectors of the energy industry from one another. It is not possible to predict what legislation, if any, may result from such bills and proposals and the effect their enactment might have upon the operations of the Company.

ELIGIBILITY FOR INVESTMENT

In the opinion of counsel, based on the five years ended April 30, 1980, the Common Shares of the Company will be, at the date of closing and provided closing occurs on or prior to April 30, 1981, investments:

(a) in which the Canadian and British Insurance Companies Act (Canada) states that a company registered under Part III thereof may invest its funds without resorting to section 63(4) of such Act;

(b) which the Foreign Insurance Companies Act (Canada) states are assets which may be vested in trust by a company registered under the said Act without resorting to section 4 of Schedule I of such Act;

(c) in which Schedule III to the Regulations made pursuant to the Pension Benefits Standards Act (Canada) states that a pension plan registered thereunder may invest its funds without resorting to the provisions of section 4 of said Schedule III;

(d) in which trust companies to which the Trust Companies Act (Canada) applies may invest their own funds without availing themselves of section 68(6) of such Act;

(e) in which The Pension Benefits Regulations, made pursuant to The Pension Benefits Act (Alberta), state that the funds of a pension plan registered thereunder may be invested without resorting to section 14(4) to such Regulations;

(f) which are qualified investments for a trust governed by a registered retirement savings plan or by a registered home ownership savings plan under the Income Tax Act (Canada);

(g) which an Act respecting insurance (Quebec) states than an insurer (as defined in section 1 thereof) incorporated under the laws of Quebec (other than a mutual association) may, without availing itself for that purpose of the provisions of section 256 thereof, acquire and hold; and

(h) which the Regulations made under the Supplemental Pension Plans Act (Quebec) state that a pension plan registered under that Act may acquire and hold without availing itself for that purpose of the provisions of section 6.17 of such Regulations, but subject to the limitations as to the amount set out in section 6.25 thereof.

At the date hereof, partners of and solicitors associated with Burnet, Duckworth & Palmer beneficially own, directly or indirectly, 400 Common Shares of the Company. On the same date, partners of and solicitors associated with Davies, Ward & Beck beneficially own, directly or indirectly, 1,725 Common Shares of the Company.

MATERIAL CONTRACTS

Except for contracts made in the ordinary course of business, the only material contracts entered into by the Company within the two years preceding the date hereof are the following:

1. Underwriting Agreement dated • , 1981 between the Company and Merrill Lynch, Royal Securities Limited. See "Plan of Distribution".
2. Warrant Indenture dated • , 1981 between the Company and The Canada Trust Company. See "Details of the Offering".
3. Joint Venture Agreement dated December 15, 1980 between Czar U.S., Europa Petroleum, Inc., and Aurora, Inc.
4. Joint Venture Agreement dated August 13, 1980 between the Company, Aurora Ltd. and Shackleton Petroleum Corporation and the Joint Venture Agreement dated August 13, 1980 between Czar U.S., Aurora, Inc., and Shackleton Petroleum, Inc.
5. Dedication Agreement dated July 31, 1980 between the Company, Consolidated Gathering Systems Limited and Sherritt Gordon Mines Limited.
6. Limited Partnership Agreement dated June 3, 1980 between Aurora Ltd., the Company and the Limited Partners of the Aurora-Czar 80-81 Energy Program and the Joint Venture Agreement dated June 3, 1980 between the Company and Aurora-Czar 80-81 Energy Program.

7. Agency Agreement dated April 18, 1980 between Merrill Lynch, Royal Securities Limited, the Company, Aurora Ltd. and The Canada Trust Company relating to Aurora-Czar 80-81 Energy Program. The commission payable to Merrill Lynch, Royal Securities Limited under this agreement was $1,969,800.

8. Limited Partnership Agreement dated May 1, 1980 between Aurora, Inc., Czar U.S. and the Limited Partners of the Czar-Aurora 1980 Oil and Gas Program.

9. Underwriting Agreement dated February 21, 1980 between the Company and Merrill Lynch, Royal Securities Limited in respect of the issuance of 1,500,000 Common Shares in 1980. The commission payable to Merrill Lynch, Royal Securities Limited under this agreement was $1,605,000.

10. Limited Partnership Agreement dated December 20, 1979 between the Company, Sun Life Assurance Company of Canada and Aurora Ltd. to form Aurora-Venus 79-80 Energy Program and Joint Venture Agreement dated December 20, 1979 between the Company and Aurora-Venus 79-80 Energy Program.

11. Petroleum Natural Gas and General Rights Conveyance dated November 30, 1979 between Aurora 77 Energy Fund, as assignor, and the Company, as assignee.

12. Limited Partnership Agreement dated July 26, 1979 between the Company, Aurora Ltd. and the Limited Partners to form Aurora-Czar 79-80 Energy Program and Joint Venture Agreement dated July 26, 1979 between the Company and Aurora-Czar 79-80 Energy Program.

13. Drilling Program Agreement dated July 2, 1979 between the Company and Copetrex Oil & Gas Ltd. Eighth Program.

14. Limited Partnership Agreement dated June 11, 1979 between Aurora, Inc. and Czar U.S., as co-general partners, and the Limited Partners to form Czar-Aurora 1979-A, U.S., Ltd.

15. Underwriting Agreement dated April 5, 1979 between the Company, Robert W. Lamond and Merrill Lynch, Royal Securities Limited in respect of the issuance of the First Preference Shares, Series A of the Company in 1979. The commission payable to Merrill Lynch, Royal Securities Limited under this agreement was $377,600.

Copies of the foregoing agreements may be inspected at the office of the Company, 10th Floor, 333 - 5th Avenue S.W., Calgary, Alberta, during normal business hours during the period of distribution to the public of the Common Shares offered hereby and for a period of thirty days thereafter.

AUDITORS, TRANSFER AGENT AND REGISTRAR AND WARRANT INDENTURE TRUSTEE

The auditors of the Company are Thorne Riddell, Chartered Accountants, 12th Floor, Bow Valley Square Two, Calgary, Alberta.

The registrar and transfer agent for the Common Shares and the trustee under the Warrant Indenture is The Canada Trust Company at Halifax, Montreal, Toronto, Calgary and Vancouver.

DISCUSSION OF VARIATIONS IN OPERATING RESULTS

The significant factors influencing the yearly operating results of the Company, during the three fiscal periods ended October 31, 1978, 1979 and 1980 are discussed below.

1979 — 1980

The Company has continued to place more Canadian properties on stream and has increased production from United States properties. Production revenue has increased $3,728,685 or 125.3% from 1979. 37% of this revenue was derived from production in the United States. Principal and interest from property dispositions, which revenue is derived mainly from production from Canadian properties disposed of, has

increased 11%. Production expense has increased 269.4% over 1979 due to increased production and to the increased use of compressors in Canada.

General and administrative expense has increased 161.6% over 1979 due to the increased staff required to handle the extensive drilling activity, particularly in the United States where the Houston office was expanded greatly in 1980. General and administrative expense of Czar U.S. represents 50% of total general and administrative expense.

Interest expense increased $1,734,667 or 402.9% over 1979 due to the use of the Company's operating lines of credit. These funds were used to finance the increased drilling activity and aggressive land acquisition policy which added $52.3 million to fixed assets during the year.

Depletion and depreciation increased by 200.4% due to the increased volume of production and the larger depletable base of assets. Part of this asset base is land acquired by Czar and held for itself and drilling fund participants. The acquisition cost of this land will be billed in part to these participants when wells are drilled on the lands.

As a result of these variations, although gross revenue increased by 88% from $4,722,186 in 1979 to $8,884,779 in 1980, net earnings decreased from $1,454,864 in 1979 to $1,034,573 in 1980. Earnings per share decreased from $.16 to $.10, or 37.5% due to a decrease in net earnings and an increase of 25% in the average number of shares outstanding. In January, 1980, 312,180 First Preference Shares, Series A were converted into 780,439 Common Shares and in March, 1980 the Company issued 1,500,000 Common Shares. Earnings per share were calculated after deducting from net earnings dividends paid on First Preference Shares, Series A of $149,947.

1978-1979

Total revenue for 1979 increased 38% over 1978. The main increase was a 79% increase in production revenue which resulted from the Company being able to place more of its production on stream. Principal and interest from property dispositions increased correspondingly as this revenue is derived from an interest in oil and gas production. There was a 66% decline in management fees received pursuant to the Copetrex agreements as the agreement in effect throughout the greater part of the year through which new prospects were being acquired did not provide for a management fee. As funds from the Copetrex limited partnerships available for exploration declined, the Company increased its supply of funds from Canadian and United States limited partnerships.

Total expenses increased 129% over 1978 due to the increased production and drilling activity of the Company. Production expenses increased 106% as a result of increased production and start-up costs on new wells. Depreciation and depletion increased 158% as a result of increased production and an increase in the depletable base caused by the extensive drilling program during the year. This extensive drilling activity was financed partly by increased bank debt and this, together with increased interest rates during the latter part of the year, resulted in increased interest expense.

Basic earnings per Common Share decreased primarily because of the dividends paid on the First Preference Shares, Series A outstanding during the year, and the reduction in management fees.

CZAR RESOURCES LTD.

CONSOLIDATED BALANCE SHEET

ASSETS

	October 31 1980	October 31 1979
Current Assets		
Accounts receivable — trade	$ 13,436,331	$ 6,252,672
— drilling programs	16,874,506	4,421,485
Inventory of supplies, at lower of cost and net realizable value	2,422,455	929,704
	32,733,292	11,603,861
Fixed Assets		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	79,976,114	27,629,456
Accumulated depletion and depreciation	3,485,091	1,226,608
	76,491,023	26,402,848
	$109,224,315	$38,006,709

LIABILITIES

	1980	1979
Current Liabilities		
Bank indebtedness (note 2)	$ 47,693,636	$ 7,233,073
Accounts payable and accrued liabilities	17,745,779	9,602,547
Drilling advances	814,127	299,600
Current portion of long-term debt	—	1,000,000
	66,253,542	18,135,220
Long-Term Debt	—	2,916,667
Deferred Income Taxes	2,176,750	2,260,029

SHAREHOLDERS' EQUITY

	1980	1979
Capital Stock (note 3)		
Authorized		
600,000 First Preference Shares with a par value of $25 each, issuable in series		
15,000,000 Common Shares without nominal or par value		
Issued		
7½% Cumulative Redeemable Convertible First Preference Shares, Series A	—	7,950,000
9,613,553 Common Shares	36,228,940	3,064,336
Retained Earnings (note 3)	4,565,083	3,680,457
	40,794,023	14,694,793
	$109,224,315	$38,006,709

Approved by the Board

(Signed) I. B. McMurtrie, Director

(Signed) Les J. Broker, Director

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended October 31				
	1980	1979	1978	1977	1976
Revenue					
Production	$6,703,575	$2,974,890	$1,658,230	$1,054,267	$201,658
Principal and interest from property dispositions	1,490,260	1,286,532	740,071	413,487	82,600
Management fees	361,105	342,298	1,002,790	605,018	189,830
Other	329,839	118,466	26,926	10,513	35,775
	8,884,779	4,722,186	3,428,017	2,083,285	509,863
Expenses					
Production	1,002,821	271,417	131,446	113,675	30,775
General and administrative	1,438,610	549,911	282,838	278,161	167,070
Interest on long-term debt	223,514	262,081	58,622	—	—
Other interest	2,165,252	430,585	225,733	11,543	375
Depletion and depreciation	2,302,395	766,326	296,602	160,397	21,908
	7,132,592	2,280,320	995,241	563,776	220,128
Earnings before income taxes	1,752,187	2,441,866	2,432,776	1,519,509	289,735
Income Taxes					
Current (recovery)	(55,587)	(129,526)	104,563	—	—
Deferred	773,201	1,116,528	795,058	524,120	99,100
	717,614	987,002	899,621	524,120	99,100
Net Earnings	$1,034,573	$1,454,864	$1,533,155	$ 995,389	$190,635
Earnings per Common Share, after deduction of dividends on First Preference Shares, Series A (note 4)	$.10	$.16	$.22	$.15	$.03

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	Year Ended October 31				
	1980	1979	1978	1977	1976
Balance at Beginning of Year	$3,680,457	$2,740,381	$1,207,226	$ 211,837	$ 21,202
Net earnings	1,034,573	1,454,864	1,533,155	995,389	190,635
	4,715,030	4,195,245	2,740,381	1,207,226	211,837
Dividends on First Preference Shares, Series A	149,947	219,072	—	—	—
Expenses of issue of First Preference Shares, Series A net of deferred income taxes of $290,400	—	295,716	—	—	—
	149,947	514,788	—	—	—
Balance at End of Year	$4,565,083	$3,680,457	$2,740,381	$1,207,226	$211,837

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended October 31				
	1980	1979	1978	1977	1976
Working capital derived from					
Operations					
Net earnings	$ 1,034,573	$ 1,454,864	$ 1,533,155	$ 995,389	$ 190,635
Items not requiring working capital	3,075,596	1,873,149	1,093,249	684,517	121,008
	4,110,169	3,328,013	2,626,404	1,679,906	311,643
Issue of long-term debt	—	1,541,667	1,375,000	—	—
Issue of Common Shares for cash and on conversion of advances from syndicates, net of share issue expenses	24,503,624	362,980	670,481	842,197	529,533
Issue of First Preference Shares, Series A for cash, net of share issue expenses	—	7,413,884	—	—	—
	28,613,793	12,646,544	4,671,885	2,522,103	841,176
Working capital applied to					
Additions to fixed assets	52,390,570	16,267,359	5,459,284	4,285,018	1,332,302
Reduction of long-term debt	2,916,667	—	—	—	—
Dividends on First Preference Shares, Series A	149,947	219,072	—	—	—
Redemption of First Preference Shares, Series A, for cash	145,500	—	—	—	—
	55,602,684	16,486,431	5,459,284	4,285,018	1,332,302
Decrease in working capital position	(26,988,891)	(3,839,887)	(787,399)	(1,762,915)	(491,126)
Working capital (deficiency) at beginning of year	(6,531,359)	(2,691,472)	(1,904,073)	(141,158)	349,968
Working capital (deficiency) at end of year	$(33,520,250)	$(6,531,359)	$(2,691,472)	$(1,904,073)	$ (141,158)

CZAR RESOURCES LTD.
Notes to Consolidated Financial Statements

(1) Accounting Policies

(a) *Principles of Consolidation*

The consolidated financial statements include the accounts of Czar Resources Ltd. and its wholly-owned subsidiaries, Czar Developments Ltd. and Czar Resources Inc.

(b) *Foreign Currency Translation*

The accounts of the foreign subsidiary are translated to Canadian dollars on the following basis:

(i) current assets and current liabilities at the rate of exchange in effect as at the balance sheet dates;

(ii) fixed assets at the rate of exchange in effect at the date on which the respective assets were acquired; and

(iii) revenue and expenses (excluding depreciation and depletion which are translated at the same rate as the related assets) at the average rate of exchange for the year.

(c) *Petroleum and Natural Gas Operations*

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized by cost center. A separate cost center is established for each country in which the Company operates, presently Canada and the United States. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells and related overhead expenditures. Such costs are depleted by cost center using the composite unit of production method based upon estimated proven developed reserves. In calculating depletion, natural gas reserves are converted to equivalent units of crude oil based on the relative net sales value of each product.

Under certain drilling programs, a significant portion of the consideration for the sale of properties by the Company to limited partnerships is payable to the Company by instalments over a period approximating 26 years. Principal and interest payments, in the aggregate, may not exceed a fixed percentage of net revenue from the wells drilled. Unpaid principal instalments total $52,376,456 at October 31, 1980 (1979 — $49,146,812). Such principal and interest payments will be recorded in the accounts of the Company as and when received.

All of the Company's exploration and development activities related to petroleum and natural gas are conducted with others; the accounts reflect only the Company's proportionate interest in such activities.

(d) *Depreciation*

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the composite unit of production method based on estimated proven developed reserves of each cost center. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

(2) Bank Indebtedness

Bank indebtedness is secured by an assignment of accounts receivable and certain petroleum and natural gas properties and revenue interests therein. The Company has agreed with its Canadian banker that it will not encumber any of its assets or dispose of any of its petroleum or natural gas properties, other than to its joint venture participants in the normal course of business, without, in each case, the consent of the bank.

(3) Capital Stock

(a) *First Preference Shares, Series A*

On March 30, 1979 the authorized share capital of the Company was increased to include 600,000 First Preference Shares with a par value of $25 each. Subsequently 320,000 shares were designated as 7½% Cumulative Redeemable Convertible Preference Shares, Series A (the "First Preference Shares, Series A") and were issued for an aggregate consideration of $8,000,000.

Changes in issued First Preference Shares, Series A were:

	Number of Shares	Consideration
Issued for cash in 1979	320,000	$8,000,000
Converted to Common Shares	(2,000)	(50,000)
Balance at October 31, 1979	318,000	7,950,000
Converted to Common Shares	(312,180)	(7,804,500)
Redeemed for cash	(5,820)	(145,500)
Balance at October 31, 1980	—	$ —

Retained earnings include a Capital Redemption Reserve Fund in the amount of $145,500 as required under the Alberta Companies Act in respect of the redemption of the 5,820 First Preference Shares, Series A, which fund is not available for the payment of dividends.

(b) *Common Shares*

On March 28, 1980 the authorized capital of the Company was increased from 10,000,000 to 15,000,000 Common Shares without nominal or par value.

Changes in the Company's issued Common Shares for the five years ended October 31, 1980 were:

	Number of Shares	Consideration
Balance at November 1, 1975	797,000	$ 609,145
Issued for cash less applicable share issue expenses of $68,717	245,000	519,283
Issued for cash on exercise of stock options	6,000	10,250
Balance at October 31, 1976	1,048,000	1,138,678
Issued on 2 for 1 stock split	1,048,000	—
Issued for cash less applicable share issue expenses of $47,553	168,000	821,697
Issued for cash on exercise of stock options	14,400	20,500
Balance at October 31, 1977	2,278,400	1,980,875
Issued on 3 for 1 stock split	4,556,800	—
Issued for cash less applicable share issue expenses of $14,579	150,000	547,921
Issued for cash on exercise of stock options	137,400	122,560
Balance at October 31, 1978	7,122,600	2,651,356
Issued for cash on exercise of stock options	96,870	362,980
Issued on conversion of First Preference Shares, Series A	5,000	50,000
Balance at October 31, 1979	7,224,470	3,064,336
Issued for cash less applicable share issue expenses of $1,070,301 (net of deferred income taxes of $856,480)	1,500,000	24,804,699
Issued for cash on exercise of stock options	108,644	555,575
Issued on conversion of First Preference Shares, Series A	780,439	7,804,330
Balance at October 31, 1980	9,613,553	$36,228,940

(c) At October 31, 1980 directors, officers and employees of the Company and Czar Resources Inc. and one other person held options to purchase 448,310 Common Shares of the Company as follows:

Date of Expiration	Exercise Price ($)	Number of Shares Optioned
Canada		
Directors and Senior Officers		
March 7, 1981	4.17	135,000
March 11, 1982	6.75	4,000
July 18, 1982	7.87	7,500
April 2, 1985	13.72	22,000
January 28, 1985	14.52	90,000
February 15, 1985	14.63	18,000
Employees		
May 17, 1982	6.97	3,000
July 6, 1982	7.31	3,500
July 18, 1982	7.87	1,000
May 13, 1985	13.28	2,100
September 21, 1985	13.39	2,400
September 28, 1985	13.61	5,100
April 2, 1985	13.72	6,000
May 23, 1985	13.95	15,300
May 24, 1985	14.17	2,400
April 15, 1985	14.18	3,000
February 14, 1983	14.63	3,000
February 15, 1985	14.63	2,100
June 22, 1985	15.41	3,000
October 6, 1985	15.53	1,500
March 13, 1985	15.75	1,000
July 20, 1985	16.31	1,500
July 14, 1985	16.43	2,400

Date of Expiration	Exercise Price ($)	Number of Shares Optioned
Other		
March 31, 1981	5.70	72,000
United States (Czar Resources Inc.)		
Directors and Senior Officers		
July 31, 1982	9.10	1,100
September 12, 1982	13.28	1,200
January 28, 1985	14.52	30,000
September 7, 1985	14.63	7,500
June 9, 1985	15.98	900
Employees		
January 22, 1983	13.90	360
June 9, 1985	15.98	450

(d) Subsequent to October 31, 1980, options were granted to senior officers and employees of Czar Resources Inc. to purchase 18,000 Common Shares at an exercise price of $14.51, expiring January 19, 1986. Options to subscribe for 7,500 Common Shares were granted to senior officers and options to subscribe for 10,500 Common Shares were granted to employees. Reference is made to note 8.

(4) Earnings Per Common Share

During April, 1977 the Company's Common Shares were split on a 2 for 1 basis and subsequently in September, 1978 the Common Shares were further split on a 3 for 1 basis. Retroactive cumulative effect of these stock splits on earnings per share data has been reflected in the accompanying financial statements.

Earnings per Common Share computations, after giving effect to the stock splits noted above, are based upon the weighted average number of shares outstanding during each year.

(5) Commitments and Contingent Liabilities

Lease commitments in respect of office premises and other equipment at October 31, 1980 aggregate approximately $6,340,000, and for each of the five years ending October 31, 1985 are: 1981 — $640,000; 1982 — $765,000; 1983 — $1,287,000; 1984 — $1,245,000; and 1985 — $996,000.

Commitments in respect of long-term drilling rig contracts at October 31, 1980 aggregate approximately $10,650,000 and for each of the two years ending October 31, 1982 are: 1981 — $9,144,000; and 1982 — $1,506,000.

Certain limited partnerships which have entered into joint ventures with the Company are required, beginning in 1981, to retire in each year up to a maximum of 10% of the limited partnerships' interests initially issued by the limited partnerships. The Company is required to purchase an interest in the assets of the limited partnerships to enable the limited partnerships to finance these obligations. The maximum obligation of the Company in 1981 in respect of such requirement is approximately $2,000,000.

(6) Segmented Information

The Company has a single line of business, which is the exploration for and the development and production of oil and gas. Information about the Company's operations by geographic segment for the year ended October 31, 1980 is as follows:

	Canada	United States	Total
Identifiable assets at October 31, 1980	$88,221,319	$21,002,996	$109,224,315
Production	$ 4,245,525	$ 2,458,050	$ 6,703,575
Principal and interest from property dispositions	1,429,654	60,606	1,490,260
	$ 5,675,179	$ 2,518,656	$ 8,193,835
Operating profit	$ 3,068,713	$ 1,819,906	$ 4,888,619
Other revenue			690,944
			5,579,563
General corporate expense			1,438,610
Interest expense			2,388,766
			3,827,376
Earnings before income taxes			$ 1,752,187

(7) Related Party Transactions

A significant shareholder, director and senior officer of the Company is a majority shareholder of a corporation which is the general partner of certain limited partnerships and the manager of certain other companies which have entered into joint ventures with the Company for the exploration and development of properties. At October 31, 1980 the said limited partnerships and companies were indebted to the Company in the aggregate amount of $13,833,365. In the year ended October 31, 1980 the charges made by the Company to such limited partnerships and companies totalled $31,730,352.

(8) Subsequent Events

(a) Reference is made to note 3.

(b) Pursuant to an Underwriting Agreement dated • , 1981 the Company has agreed to sell to an underwriter • Common Shares of the Company carrying the right to receive • Common Share Purchase Warrants for a cash consideration of $ • .

AUDITORS' REPORT

To the Directors of
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. as at October 31, 1980 and 1979 and the consolidated statements of earnings, retained earnings and changes in financial position for each of the five years ended October 31, 1980. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at October 31, 1980 and 1979 and the results of its operations and the changes in its financial position for each of the five years ended October 31, 1980 in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Canada
February 13, 1981,
except as to note 8(b)
which is as of
• , 1981.

Chartered Accountants

PURCHASERS' STATUTORY RIGHTS

Sections 70, 126 and 135 of The Securities Act, 1978 (Ontario) provide, in effect, that when a security is offered in the course of a distribution or a distribution to the public:

(a) a purchaser will not be bound by a contract for the purchase of such security if written or telegraphic notice evidencing his intention not to be bound is received by the dealer from whom the purchaser purchased the security no later than midnight on the second business day after the latest prospectus and any amendment to the prospectus offering such security is received or deemed to be received by the purchaser or his agent, and

(b) if a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and, subject to the limitations set forth in such Act,

(1) the purchaser has a right of action for damages against,

(i) the issuer or a selling security holder on whose behalf the distribution is made,

(ii) each underwriter required to sign the certificate required by section 58 of such Act,

(iii) every director of the issuer at the time the prospectus or amendment was filed,

(iv) every person or company whose consent has been filed pursuant to a requirement of the regulations under such Act but only with respect to reports, opinions or statements made by them, and

(v) every other person or company who signed the prospectus or the amendment,

but no action to enforce the right can be commenced by a purchaser more than the earlier of 180 days after the purchaser first has knowledge of the facts giving rise to the cause of action or three years after the date of the transaction that gave rise to the cause of action, or

(2) where the purchaser purchased the security from a person or company referred to in (i) or (ii) above or from another underwriter of the securities, he may elect to exercise a right of rescission against such person, company or underwriter, in which case he shall have no right of action for damages against such person, company or underwriter, but no action to enforce this right can be commenced by a purchaser more than 180 days after the date of the transaction that gave rise to the cause of action.

Sections 64 and 65 of The Securities Act (Alberta), sections 71 and 72 of The Securities Act (Saskatchewan) and sections 63 and 64 of The Securities Act (Manitoba) provide, in effect, that when a security is offered in the course of a distribution to the public referred to in such Acts:

(a) a purchaser will not be bound by a contract for the purchase of such security if written or telegraphic notice evidencing his intention not to be bound is received by the vendor or his agent not later than midnight on the second business day after the prospectus or amended prospectus offering such security is received or is deemed to be received by the purchaser or his agent, and

(b) a purchaser has the right to rescind a contract for the purchase of such security, while still the owner thereof, if the prospectus or any amended prospectus offering such security contains an untrue statement of a material fact or omits to state a material fact necessary in order to make any statement therein not misleading in the light of the circumstances in which it was made, but no action to enforce this right can be commenced by a purchaser after the expiration of 90 days from the later of the date of such contract or the date on which such prospectus or amended prospectus is received or is deemed to be received by the purchaser or his agent.

Sections 60 and 61 of the Securities Act (British Columbia) provide, in effect, that when a security is offered to the public in the course of primary distribution:

(a) a purchaser has the right to rescind a contract for the purchase of such security, while still the owner thereof, if a copy of the last prospectus together with financial statements and reports and summaries of reports relating to the security, as filed with the Superintendent of Brokers of British

Columbia, were not delivered to him or his agent prior to delivery to either of them of the written confirmation of the sale of the security. Written notice of intention to commence an action for rescission of the contract to sell the security must be served on the person who contracted to sell the security within 60 days of the date of delivery of the written confirmation of the sale of the security, but no action to enforce this right can be commenced after the expiration of three months from the date of service of such notice, and

(b) a purchaser has the right to rescind a contract for the purchase of such security, while still the owner thereof, if the prospectus or any amended prospectus offering such security contains an untrue statement of a material fact or omits to state a material fact necessary in order to make any statement therein not misleading in the light of the circumstances in which it was made, but no action to enforce this right can be commenced by a purchaser after the expiration of 90 days from the date of such contract or the date on which such prospectus or amended prospectus is received or is deemed to be received by the purchaser or his agent, whichever is the later.

Reference is made to the aforesaid Acts for the complete texts of the provisions under which the foregoing rights are conferred. The foregoing summaries are subject to the express provisions thereof.

Dated: February 13, 1981

CERTIFICATE OF THE COMPANY

The foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part 7 of the Securities Act (British Columbia), Part 7 of The Securities Act (Alberta), Part VIII of The Securities Act (Saskatchewan), Part VII of The Securities Act (Manitoba), Part XIV of The Securities Act, 1978 (Ontario), the Securities Act (Quebec), section 13 of the Securities Act (New Brunswick), and by the respective regulations thereunder.

(Signed) I. B. MCMURTRIE
President

(Signed) B. RAWLYCK
Chief Financial Officer

On behalf of the Board of Directors:

(Signed) CHRISTOPHER BILL
Director

(Signed) LES J. BROKER
Director

CERTIFICATE OF THE UNDERWRITER

To the best of our knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part 7 of the Securities Act (British Columbia), Part 7 of The Securities Act (Alberta), Part VIII of The Securities Act (Saskatchewan), Part VII of The Securities Act (Manitoba), Part XIV of The Securities Act, 1978 (Ontario), the Securities Act (Quebec), section 13 of the Securities Act (New Brunswick), and by the respective regulations thereunder.

MERRILL LYNCH, ROYAL SECURITIES LIMITED

By: (Signed) CHRISTOPHER BILL

Merrill Lynch, Royal Securities Limited is, indirectly, a wholly-owned subsidiary of Merrill Lynch, Pierce, Fenner & Smith Inc.

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